SUPREME COURT, U.S.
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No. 99-

IN THE

Supreme Court of the United States

SUN INTERNATIONAL NORTH AMERICA, INC.,

Petitioner,

v.

FRED LOWENSCHUSS, individually and as Trustee of FRED LOWENSCHUSS, I.R.A., LAURANCE LOWENSCHUSS, I.R.A. and FRED LOWENSCHUSS ASSOCIATES PENSION PLAN,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

The *Bankruptcy Code* expresses a clear preference for creditors over shareholders in the distribution of the assets of the estate of a bankrupt and broadly authorizes a trustee in bankruptcy to avoid, and to recover, payments made to shareholders or others for consideration that is less than the reasonably equivalent value of the payments made. In 1982, Congress enacted § 546(e) to the *Code*, carving out an exception to this broad power of trustees designed to insulate the clearing and settlement system of the Nation's securities industry and participants in that system from the potentially devastating impact on that system of a substantial recovery by a trustee of funds from a participant that would leave the participant insolvent. In direct conflict with a decision of the Eleventh Circuit, the Third Circuit held in this case that a payment made by a bankrupt to its shareholders in the context of a leveraged buyout is not subject to the trustee's avoidance and recovery power notwithstanding that the payment was made completely outside the securities clearing and settlement system. This holding presents the following question:

Did Congress in 1982 deprive trustees in bankruptcy of their longstanding power to avoid and to recover payments made by a bankrupt to its shareholders for less than reasonable value where the recovery of those payments poses no danger to the clearing and settlement system of the Nation's securities markets or to participants in that system?

PARTIES INVOLVED AND RULE 29.6 STATEMENT

The caption identifies all of the parties to the proceedings in the Court of Appeals. Sun International North America, Inc. ("SINA") was known as Resorts International, Inc. until June 30, 1995, and as Griffin Gaming & Entertainment, Inc. from June 30, 1995 until February 6, 1997. SINA is a wholly owned subsidiary of Sun International Hotels Limited, which is a publicly traded company.

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IN THE

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SUN INTERNATIONAL NORTH AMERICA, INC.,

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v.

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—

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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Petitioner respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit in this case. This Court should grant the writ because this case presents an important question of federal bankruptcy law that the courts of appeals and district courts have resolved in conflicting ways that preclude the uniform nationwide application of an important federal bankruptcy law.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 181 F.3d 505 and is reprinted at App. 1a-23a. The opinion of the United States District Court for the District of New Jersey is unreported and is reprinted at App. 24a-46a. The opinion of the United States Bankruptcy Court for the District of New Jersey is unreported and is reprinted at App. 47a-105a. The Bankruptcy Court's Order Amending Judgment and Denying Stay, and Judgment, are unreported and are reprinted at App. 106a-14a.

JURISDICTION

The Bankruptcy Court had jurisdiction under 28 U.S.C. § 157(b)(1) and § 1334(b). The District Court had jurisdiction under 28 U.S.C. § 158(a)(1). The Court of Appeals had jurisdiction under 28 U.S.C. § 1291. The opinion of the Court of Appeals was entered on June 30, 1999, and this petition is being filed within 90 days of that date. This Court has jurisdiction to review the judgment of the Court of Appeals by writ of certiorari under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

11 U.S.C. § 546(e)[1] provides as follows:

> Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 101, 741, or 761 of this title, or settlement

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[1] The terms "*Bankruptcy Code*" or "*Code*" refer throughout to 11 U.S.C.

payment, as defined in section 101 or 741 of this title, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency, that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

11 U.S.C. § 741(8) provides as follows:

"settlement payment" means a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade.

11 U.S.C. § 550 provides in pertinent part as follows:

(a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from --

(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or

(2) any immediate or mediate transferee of such initial transferee.

STATEMENT OF THE CASE

The facts relevant to this petition are few, simple, and undisputed. Respondents ("Lowenschuss") were shareholders of a predecessor of petitioner ("Resorts") when that company was

acquired in a leveraged buyout ("LBO") for a price of $36 per share of outstanding common stock. In the typical LBO, as here, an investor negotiates with the management of the target company a price to be paid for each share of outstanding stock held by the shareholders of the target company. App. at 3a. Shareholders, including Lowenschuss, were given the option of tendering their shares for $36 per share or seeking an appraisal in an attempt to establish a higher value. Lowenschuss initially refused to tender his shares, opting instead to pursue statutory appraisal rights. *Id.*

The LBO closed in 1989, after which all shares of Resorts' old stock were canceled and were no longer traded on any exchange. Resorts retained Chase Manhattan Bank ("Chase") to act as paying agent and established an account at Chase for the distribution of cash to tendering shareholders. App. at 4a. Virtually all shareholders except Lowenschuss tendered their canceled shares and received $36 in cash for each share.

Nearly a year after opting to seek appraisal, Lowenschuss changed his mind and tendered his canceled shares to Resorts, which paid him nearly $4 million. The details of the transfer are as follows: Lowenschuss held his shares of Resorts stock in certificate form. He carried those certificates to Merrill Lynch, his stockbroker, gave them to the cashier, and asked that they be tendered to Chase for his account. Merrill Lynch transmitted the shares to Chase, and payment was made by Chase, which sent a check drawn on Resorts' account to Merrill Lynch, which deposited the funds in Lowenschuss' account. *See* App. at 4a. Neither Merrill Lynch nor Chase ever obtained any beneficial interest in the funds or the canceled stock certificates, and both entities acted merely as conduits and assumed none of the obligations or liabilities that are assumed by participants in the clearing and settlement system of the Nation's securities industry

in connection with the routine, common purchase and sale of publicly traded stock.[2] *See id.* This swap of stock for cash occurred less than four months before Resorts filed for bankruptcy reorganization and at a time when it was already insolvent. Indeed, it was Lowenschuss' recognition that Resorts was insolvent, and his desire to be paid the full $36 per share before the inevitable filing of a Chapter 11 case, that caused him to abandon his appraisal claim. *See* App. at 55a-57a.

Resorts sued Lowenschuss, seeking to reverse the swap under, *inter alia*, the provision of the *Code*, now codified at 11 U.S.C. § 548(a)(1)(B), that permits an insolvent debtor to recover assets transferred by the bankrupt, within one year before the filing of a petition, for less than reasonably equivalent value so that those assets can be distributed to creditors of the bankrupt under the system of priorities established by Congress in which shareholders are generally last in line. The Bankruptcy Court ruled in Resorts' favor on grounds not at issue here and also held that Resorts' avoidance action was barred by § 546(e), under which a trustee "may not avoid a transfer that is a . . . settlement payment, as defined in section . . . 741, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency." That court concluded that the swap involved a "settlement payment" made by or to a stockbroker or a financial institution as that term of art is defined in § 741(8) of the *Code*. App. 95a-97a. The District Court reversed the Bankruptcy

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[2] That complex system involving multiple layers of stockbrokers and a central clearing agency is described in detail *infra* at 14-16. Under that system, stockbrokers and other participants issue a series of guarantees that each will abide by these various obligations whether another participant is unable or refuses to do so.

Court on issues not germane here and otherwise affirmed the Bankruptcy Court.

The Third Circuit affirmed. In doing so, that court rejected Resorts' argument that the payment involved was not a "settlement payment" under § 741(8). It also rejected Resorts' related argument that § 546(e) did not apply to the swap at issue because the payment was not "by or to" an entity listed in § 546(e) as eligible for the protection of that provision (hereafter "protected entity" or "protected entities"). App. 20a-22a. Resorts' arguments were grounded in the undisputed facts that neither Lowenschuss' broker, Merrill Lynch, nor the financial institution that acted as distribution agent, Chase, ever had a beneficial interest in the transferred property and that neither ever issued in connection with this swap any of the guarantees that inhere in transactions that occur in connection with the processing of a common purchase or sale of stock within the securities clearance and settlement system.

In rejecting Resorts' position, the Third Circuit initially followed its own prior decision holding that the definition of "settlement payment" in § 741(8) of the *Code* "is extremely broad" and that therefore "it is likely to encompass the instant transaction." App. at 18a. In that prior case, *Bevill, Bresler & Schulman Asset Management Corp. v. Spencer Savings & Loan Ass'n*, 878 F.2d 742 (3d Cir. 1989), the Third Circuit -- embracing what purported to be a plain language analysis -- had indeed construed the definition of "settlement payment" broadly, but only after "confess[ing] to [the] possibility" that the definition in section 741(8) suffers from "facial ambiguity." *Id.* at 752.

Acknowledging that *Bevill* had not involved the type of payment at issue here, the Third Circuit looked to two decisions of the Tenth Circuit for additional guidance. The first of these cases, *Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846 (10th Cir. 1990) ("*Kaiser I*"), was cited as support for the unremarkable proposition that "[i]n the securities industry, a settlement payment

is generally the transfer of cash or securities made to complete a securities transaction." App. at 19a. *Kaiser I* had itself recognized that the definition of "settlement payment" in § 741(8) was "somewhat circular," *id.* at 848, but it also readily embraced the notion that the reach of "settlement payment" was "extremely broad," citing and quoting none other than *Bevill*. *Id.*

Then, acknowledging that other federal courts had held that the term "settlement payment" does not apply to payments for shares tendered as part of an LBO because "'the system of intermediaries and guarantees' that normal securities transactions involve is not in play in an LBO,"[3] the Third Circuit cited and relied on yet another Tenth Circuit case, *Kaiser Steel Corp. v. Pearl Brewing Co.*, 952 F.2d 1230 (10th Cir. 1991) ("*Kaiser II*"), *cert. denied*, 505 U.S. 1213 (1992), as well as *Bevill & Jonas v. Resolution Trust Corp. (In re Comark)*, 971 F.2d 322, 325 (9th Cir. 1992), for the proposition that "the term 'settlement payment' is a broad one that includes almost all securities transactions." App. at 20a. Not surprisingly, *Kaiser II* had relied on *Kaiser I*, *Bevill* and the Bankruptcy Court's earlier decision in *Jonas v. Farmer Brothers Co. (In re Comark)*, 124 B.R. 806 (Bankr. C.D. Cal. 1991). *Kaiser II*, 952 F.2d at 1237. And, of course, the Ninth Circuit in *Comark* had relied on *Kaiser II*. 971 F.2d at 325. From these circular holdings, the Third Circuit concluded that "[a] payment for shares during an LBO is obviously a common securities transaction, and therefore we hold that it is also a settlement payment for the purposes of section 546(e)." App. at 20a.

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[3] App. at 19a, citing and quoting, *e.g.*, *Zahn v. Yucaipa Capital Fund*, 218 B.R. 656, 676 (D.R.I. 1998).

Having disposed of Resorts' "settlement payment" argument, the Third Circuit turned to Resorts' related contention that the exception created by § 546(e) to the broad power of a trustee to avoid and recall payments by a bankrupt for less than reasonable value was not available to shareholders in an LBO situation because in such a situation -- as here -- the stockbroker and the financial institution involved in the transaction are nothing more than intermediaries or conduits for the transmittal of shares and funds in which they have no beneficial interest. Resorts contrasted that situation with one in which either Merrill Lynch or Chase might have handled these shares and funds in the course of a "common" trade or exchange of stock for money in a transaction processed through the securities clearing and settlement system. Resorts relied on the Eleventh Circuit's decision in *Munford v. Valuation Research Corp.*, 98 F.3d 604 (11th Cir. 1996), *cert. denied sub nom. DFA Inv. Dimensions Group Inc. v. Munford, Inc.*, __ U.S. __, 118 S. Ct. 738, 739 (1998) (No. 97-550), and *sub nom. Munford v. Munford, Inc.*, __ U.S. __, 118 S. Ct. 739 (1998) (No. 97-591). In that case, funds necessary to purchase all outstanding stock of the publicly traded company to be acquired in an LBO had been deposited in a bank -- a "financial institution" -- that played a role in that transaction identical to that played by Chase in the case at bar. After the post-acquisition company filed a Chapter 11 case, the trustee sought to avoid and recall those payments.

The Eleventh Circuit, declining to reach the question whether those payments constituted "settlement payments" under § 741(8), assumed that they were but focused on the language of § 546(e) under which a settlement payment must be "made by or to a ... financial institution, or securities clearing agency." Notwithstanding that the bank in its case was clearly a "financial institution," the Eleventh Circuit concluded that the bank was not, under § 550 of the Code, a "transferee" of the funds involved because the bank had done nothing more than receive the shares of stock from the shareholders of the old company and pay to the

shareholders the buy-out price from funds delivered to it in advance by the purchaser. *Id.* at 610. Further, the court held squarely that § 546(e) "offers no protection from the trustees [sic] avoiding powers to shareholders . . . ." *Id.*

The Third Circuit, quoting extensively from the majority opinion in *Munford*, App. at 20a-21a, expressly rejected *Munford's* rationale and holding and expressly adopted the position of the *Munford* dissent, *id.* at 21a, that the involvement of a "financial institution" as nothing more than a conduit in an LBO transaction was sufficient to confer on tendering shareholders the protection of § 546(e)'s safe harbor. *Id.*

REASONS FOR GRANTING THE WRIT

Section 546(e) stands at the crossroads of two important federal policies. On the one hand, the *Bankruptcy Code* has long granted trustees broad powers to avoid transfers of a company's assets in close proximity to the filing of a Chapter 11 case to ensure, among other things, that the transferees do not unjustly benefit at the expense of creditors. Where, as here, the transfer was made to a shareholder of the bankrupt, the avoidance power advances an even broader judgment of Congress that shareholders or other owners of a bankrupt corporation should stand last in line when the assets of a bankrupt are distributed. Here, Lowenschuss placed himself at the back of the line when he declined to accept $36 for each share of his stock on the gamble that he could get more by seeking an appraisal.

On the other hand, it has been more recently recognized by Congress that the securities clearing and settlement system plays a vital role in the functioning of the commodities and securities markets that are themselves the subject of extensive federal regulation. In response to concerns that the use of the trustee's avoidance and recovery powers might threaten the integrity of the securities industry's clearing and settlement system,

Congress enacted § 546(e) in 1982 to protect the clearance and settlement system and certain specified participants in that system from a trustee's avoidance power. There is no disagreement among any of the many federal court decisions implicated in this petition that protection of the clearance and settlement system was the only stated purpose of the 1982 legislation at issue here.

Section 546(e) exempts from the avoidance powers "settlement payments" made "by or to" certain protected entities. In this case, the Third Circuit interpreted § 546(e) in a manner that conflicts with the interpretation of that statute by other lower federal courts in two respects. First, the Third Circuit held that § 546(e) exempts from a trustee's broad avoidance powers a swap of shares for cash between a corporation and its shareholders in an LBO even if that swap was effected through an otherwise "protected" entity that simply acted as a conduit in the transfer. The Eleventh Circuit, in *Munford*, and other lower federal courts (discussed *infra*) have squarely held that § 546(e) does not apply to a shareholder simply because of the fortuity that a protected entity participated in the swap as a "mere conduit." Second, the Third Circuit adopted a broad definition of the term "settlement payment" that conflicts with the narrower interpretation of that term by other lower federal courts.

In sum and substance, the Third Circuit's decision in this case effectively exempts from the avoidance powers conferred on trustees by Congress for more than 100 years any transfer of cash or securities that flows in connection with the consummation of an LBO in which any protected entity identified in § 546(e) participates. The decision of the Eleventh Circuit in *Munford* and decisions of other lower federal courts do not exempt such transfers from the trustees' power. In view of the fundamental policies underlying and sought to be protected by § 546(e), the conflicting decisions of the Third and Eleventh Circuits and other lower federal courts present issues of substantial importance that merit uniform treatment by all courts and thus warrant the issuance

of a writ of certiorari to the Third Circuit to resolve these multiple, recurring conflicts and to settle the law in this important area of bankruptcy jurisprudence.

A. Section 546(e) is an important provision of the *Bankruptcy Code* that requires a uniform national interpretation

The commencement of a bankruptcy case creates an "estate" consisting of all property of the debtor wherever located. *Code* § 541. The affairs of the debtor are then managed by a trustee or, under some circumstances, the debtor itself as a debtor in possession. *Code* §§ 323, 704, 1101 & 1107. Among the obligations of the trustee is to assemble the debtor's property, which often means recovering it from persons to whom it was transferred. *Code* §§ 550; 704(1).

The trustee's tools for recapturing property include various actions under *Code* §§ 544, 547 & 548. This Court, other federal courts and commentators have recognized these sections as essential and powerful weapons in achieving the fair and equitable treatment of creditors.[4] Avoidance actions are available to the trustee not only in Chapter 11 reorganization cases like this one, but also in bankruptcy cases under Chapters 7 and 13.[5]

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[4] *Union Bank v. Wolas*, 502 U.S. 151, 160-61 (1991) (§ 547); *Gaudet v. Babin (In re Zedda)*, 103 F.3d 1195, 1201 (5th Cir. 1997) (§ 544); 5 *Collier on Bankruptcy* § 548.01, 548-5 (L.P. King, ed. 15th ed. 1999).

[5] For the twelve-month period ended September 30, 1998, 1,436,964 cases were commenced under the Bankruptcy Code. 1998 Admin. Office of the U.S. Courts, Jud. Bus. U.S. Cts. 34,

[Footnote continued on next page]

Under the Bankruptcy Act of 1898 and the Bankruptcy Reform Act of 1978, the latter of which is the original version of the current *Code*, transactions involving the transfer of securities enjoyed no special protection from avoidance actions. Moreover, avoidance actions were available to attack merger transactions, including leveraged buyouts.[6]

Congress added current § 546(e) to the Code in 1982 to exempt certain securities transactions from most avoidance actions. The provision exempts from most avoidance actions all pre-petition "settlement payments" and "margin payments" made by or to certain identified types of entities, including most significantly financial institutions, stockbrokers, and clearing

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[Footnote continued from previous page]

Table F. The Third Circuit is perhaps the most important court of appeals for bankruptcy matters because of the significance of the location within that Circuit of the United States District Court for the District of Delaware. That District has become the most active venue for the filing of large, complex corporate reorganizations. Recent examples include the reorganizations of Continental Airlines, Trans World Airlines, Montgomery Ward, Marvel Comics, Loewen Group, Color Tile, Inc., Primary Health Systems, Inc., Columbia Gas Systems, Inc., and Grand Union.

6 *See United States v. Tabor Ct. Realty Corp.*, 803 F.2d 1288 (3d Cir. 1986), *cert. denied sub nom McLellan Realty Co. v. United States*, 483 U.S. 1005 (1987); *Kupetz v. Wolf*, 845 F.2d 842 (9th Cir. 1988); *Wieboldt Stores, Inc. v. Schottenstein*, 94 B.R. 488, 499-500 (N.D. Ill. 1988), *on recons. in part*, 1989 WL 18112 (N.D. Ill.), and *motion to clarify allowed*, 1989 WL 51068 (N.D. Ill. 1989).

agencies.[7] Section 550 of the *Code* identifies the persons from whom the trustee may recover property. The trustee may seek to recover the transferred property only from a "transferee" within the meaning of § 550. Not every person who has had custody of the transferred property is a transferee. "The Bankruptcy Code does not define 'transferee' and there is no legislative history on the point." *Raleigh v. Schottenstein (In re Wieboldt Stores, Inc.)*, 131 B.R. 655, 665 (N.D. Ill. 1991). The Courts of Appeals agree, however, that "the minimum requirement of status as a 'transferee' is dominion over the money or other asset, the right to put money to one's own purposes." *Bonded Fin. Servs., Inc. v. European Am. Bank*, 838 F.2d 890, 893 (7th Cir. 1988).[8] *See Barnhill v. Johnson*, 503 U.S. 393, 401 (1992) (in avoidance action, transfer does not occur until debtor relinquishes "full control" over the property transferred).[9] Although the 1982 amendments to the

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[7] The only avoidance actions that may be brought against such transfers are those under *Code* § 548(a)(1)(A), under which the claim must be based on actual intent to defraud or hinder creditors.

[8] *Accord Christy v. Alexander & Alexander of N.Y., Inc. (In re Finley, Kumble et al.)*, 130 F.3d 52, 57 (2d Cir. 1997), *cert. dismissed*, ___ U.S. ___, 118 S. Ct. 2295 (1998); *Nordberg v. Societe Generale (In re Chase & Sanborn Corp.)*, 848 F.2d 1196, 1200 (11th Cir. 1988)

[9] Thus, a trustee may not bring an avoidance action against, for example, an escrow agent that temporarily held the transferred funds. *See Finley, Kumble, et al.*, 130 F.3d at 56 ("Every Court of Appeals to consider this issue has squarely rejected a test that equates mere receipt with liability, declining to find 'mere conduits' to be initial transferees . . . . We join these

[Footnote continued on next page]

Code included a definition of "settlement payment" in § 741(8), the courts are in general agreement that it is necessary to look beyond the "plain language" of that provision in order to discern the meaning of "settlement payment" in a particular context. *Brandt v. Hicks, Muse & Co. (In re Heathco Int'l, Inc.)*, 195 B.R. 971, 983 (Bankr. D. Mass. 1996) (the definition is "as opaque as it is circular."). *See Bevill, Bresler*, 878 F.2d at 752 ("we confess to [the] possibility" that the definition in § 741(8) suffers from "facial ambiguity"); *Kaiser I*, 913 F.2d at 848 (definition is "somewhat circular"); *Zahn v. Yucaipa Capital Fund*, 218 B.R. 656, 675 (D.R.I. 1998) ("This definition defies plain meaning"); *Wieboldt*, 131 B.R. at 663 (*Code* "cryptically defines" settlement payment using "circuitous verbiage").

Most courts that have interpreted § 546(e) have, therefore, reviewed its legislative purpose to determine its applicability to particular transfers in particular contexts.[10] Indeed, all of the federal courts that have been required to apply § 546(e) and the term "settlement payment" to a set of facts have agreed that the purpose of that exception to the trustees' broad avoidance powers was to prevent the use of those powers in a way that could destroy

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other circuits in adopting the 'mere conduit' test for determining who is an initial transferee under § 550(a)(1).") (citation omitted).

10 *E.g., Kaiser I*, 913 F.2d at 848-49; *Kaiser II*, 952 F.2d at 1237-38; *Jewel Recovery, L.P. v. Gordon*, 196 B.R. 348, 352-53 (N.D. Tex. 1996); *KSC Recovery, Inc. v. First Boston Corp. (In re Kaiser Merger Litig.)*, 168 B.R. 991, 1001 (D. Colo. 1994); *Wieboldt*, 131 B.R. at 663-64. *See also Bevill, Bresler*, 878 F.2d at 747 (discussing legislative history of § 546(e)).

the integrity of the elaborate web of guarantees that link participants in the clearing and settlement system supporting the securities and commodities markets and to protect certain participants in that system:

> The commodities and securities markets operate through a complex system of accounts and guarantees. Because of the structure of the clearing systems in these industries and the potential volatile nature of the markets, certain protections are necessary to prevent *the insolvency of one commodity or security firm* from leading to the insolvency of other firms and possibly threatening the collapse of the affected market.

H.R. Rep. No. 420, 97th Cong., 2d Sess. 261 (1982) (emphasis added).

One district court recently described the clearing and settlement system and Congress's avowed purpose in 1982 to protect that system and specified participants in it as follows:

> The securities industry utilizes a "clearance and settlement" system, wherein parties use intermediaries to make trades of public stock which are instantaneously credited, but in which the actual exchange of stock and consideration therefor takes place at a later date. This later date is known as the "settlement" date; on this date the trade is "settled" by actually exchanging what was promised on the trade date.
>
> The intermediaries' role in this system is critical; typically there are several layers of brokers on each side of a trade, with a clearing agency positioned in the middle. The clearing agency, on the date of the trade itself, makes entries (credits or debits) in the accounts of its members (financial institutions or brokers), which

> reflect the trade. Thus, while settlement occurs later, the trade itself is functionally instantaneous. The system depends upon a series of guarantees, made by all parties of the chain, that they will live up to their obligations regardless of a default by another party in the chain. These guarantees allow the parties to trade free of worry about events between the trade date and the settlement date.
>
> The need to preserve the stability of this system led Congress to create the § 546(e) exception to the trustee's avoidance powers. If the pre-bankruptcy trades *by a bankrupt intermediary* could be set aside, then the guarantees that allow the system to function would be threatened, the parties could not proceed with confidence, and a bankruptcy by one party in the chain could spread to other parties in the chain, threatening a collapse of the entire industry.

Zahn, 218 B.R. at 675-76 (citations omitted) (emphasis added) (*citing Jewel Recovery*, 196 B.R. at 352, and *Wieboldt*, 131 B.R. at 664).[11]

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[11] The description above tracks the description of the clearance and settlement system that was put before Congress in 1981 in the written statement of Commissioner Longstreth of the Securities and Exchange Commission. *See* Hearings on Bankruptcy of Commodity and Securities Brokers Before the Subcommittee on Monopolies and Commercial Law of the House Committee on the Judiciary, 97th Cong., 1st Sess. 243-52 (1981). As noted *infra*, the Commission has more recently taken the position in *Munford* that the 1982 amendments broadly limited the power of trustees in bankruptcy to avoid

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B. The lower federal courts are divided on whether a transfer is "by or to" one of the entities identified in § 546(e) if those entities are involved in the transfer, not as beneficial owners, but only as conduits, of the property

The courts of appeals are sharply divided on the question whether § 546(e) bars avoidance actions where a protected entity participates in a transaction while acting only as a conduit. In the case at bar Lowenschuss, the shareholder, sought protection from the trustee's avoidance powers solely on the basis of the involvement in the LBO of Chase, which received and disbursed funds, and Merrill Lynch, which turned over to Chase the stock certificates of its customer, Lowenschuss. Resorts contended that because Lowenschuss' stockbroker and Resorts' distribution agent were merely conduits of the transferred property, the transfer was in fact between Lowenschuss and Resorts directly, and that neither Chase nor Merrill Lynch were transferees under *Code* § 550. The Third Circuit held that a transfer may be "by or to" a bank or broker for purposes of § 546(e) even if the bank and/or broker are not transferees for purposes of § 550.

The *Munford* court held that, in an LBO transaction like this one, an avoidance action against the cashed-out former shareholder is not barred by § 546(e) even if (as here) the cash is

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and recall payments like these here. As Resorts will demonstrate on the merits, neither Commissioner Longstreth nor any other witness who testified at those hearings ever remotely suggested that the amendments under consideration would or should apply to payments made in connection with the consummation of LBO transactions.

disbursed to the shareholder by a financial institution that is holding the funds as distribution agent. The Eleventh Circuit reasoned that, in such cases, § 546(e) simply does not apply because, although the payment is "from a financial institution," that financial institution -- a bank -- is not under those facts a "transferee." The bank never acquired a beneficial interest in the funds, and thus the transaction is properly viewed as being between the bankrupt corporation/buyer and the shareholder/seller, neither of whom is among the protected entities listed in § 546(e). Under this analysis, the payment at issue is not "by or to" any entity identified in § 546(e) because no financial institution or broker involved is a transferee under § 550.

The Eleventh Circuit analyzed the case as follows:

> [S]ection 546(e) is not applicable *unless* the transfer (or settlement payment) was "made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency." 11 U.S.C. § 546(e). Here, the transfers/payments were made *by* Munford *to* shareholders. None of the entities listed in section 546(e) -- *i.e.*, a commodity broker, forward contract merchant, stockbroker, financial institution, or a securities clearing agency -- made or received a transfer/payment. Thus, section 546(e) is not applicable.
>
> True, a section 546(e) financial institution was presumptively involved in this transaction. But the bank here was nothing more than an intermediary or conduit. Funds were deposited in the bank and when the bank received the shares from the selling shareholders, it sent funds to them in exchange. *The bank never acquired a beneficial interest in either the funds or the shares.*
>
> Importantly, a trustee may only avoid a transfer to a "transferee." *See* 11 U.S.C. § 550. Since the bank

> never acquired a beneficial interest in the funds, it was not a "transferee" in the LBO transaction. Rather, *the shareholders were the only "transferees" of the funds here*. And, of course, section 546(e) offers no protection from the trustees [sic] avoiding powers to shareholders; rather, section 546(e) protects only commodity brokers, forward contract merchants, stockbrokers, financial institutions, and securities clearing agencies. Accordingly, regardless of whether the payments qualify as settlement payments, section 546(e) is not applicable since the LBO transaction did not involve a transfer to one of the listed protected entities.

98 F.3d at 610 (*in original*) (emphasis added) (citations omitted).

The opinion of the Third Circuit in this case acknowledges the split in authority that it has created in this case. Quoting at length from the Eleventh Circuit's ruling in *Munford*, the Third Circuit ruled:

> We, however, are more persuaded by the dissent [in *Munford*] which relied, as we do, on the plain language of the statute. Section 546(e) protects from trustee's avoidance powers settlement payments made "by . . . a financial institution." The majority in *Munford* seems to have read into section 546(e) the requirement that the "commodity brokers, forward contract merchants, stockbrokers, financial institutions, and securities clearing agencies" obtain a "beneficial interest" in the funds they handle for the section to be applicable. This requirement is not explicit in section 546.
>
> * * *

> Nor does it logically follow from the application of section 550, which allows trustees to recover property that was the subject of an avoided transfer from the transferee, *see* 11 U.S.C. § 550, as the *Munford* majority seemed to indicate.

See App. at 21a-22a & n.11 (citations omitted).[12]

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[12] Although the Third Circuit attempts to wrap itself in the mantle of the "plain meaning" rule, this Court has observed in the context of interpreting another section of the *Code* in *United Savings Ass'n of Texas v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365 (1988), that "viewed in the isolated context of [the single statutory section], the phrase could reasonably be given the meaning [asserted by the Third Circuit]. Statutory construction, however, is a holistic endeavor." *Id.* at 371. A provision is "often clarified by the remainder of the statutory scheme . . . ." *Id.* (citations omitted). That is the case here, because the introductory phrase of § 546(e) cross references to other sections of the *Code*, namely §§ 544, 545, 547, 548(a)(1)(B) & 548(b). It is a transfer avoidable under one of those sections -- and only one of those sections -- that is exempted from avoidance by § 546(e). The only transfer that can be avoided under those sections is "any transfer of an interest of the *debtor* in property." 11 U.S.C. § 548(a) (emphasis added). Given that § 546(e) exempts otherwise avoidable transfers from avoidance, the words "made by . . . a financial institution" must necessarily apply only when the financial institution is the *debtor*. If the financial institution is not the debtor, a payment made by the financial institution can never be avoided under §§ 544, 545, 547, 548(a)(1)(B) or 548(b), and there would be no need to interpret § 546(e) to exempt a

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The Court of Appeals' ruling in this case constitutes an acknowledged inter-circuit conflict among the Circuit Courts that is heightened by the district and bankruptcy court decisions that are similarly irreconcilable. Resolution of this conflict is of great importance to the proper administration of the Nation's bankruptcy laws.

C. The lower courts are divided as to whether an exchange of securities for cash constitutes a "settlement payment" under § 546(e)

The ruling below also deepens another conflict among the lower federal courts concerning the proper interpretation of the term "settlement payment." Specifically, is § 546(e) an exception that applies to any transfer in which securities change hands, or does § 546(e) apply only to those common securities transactions involving protected entities that are participants in the clearing and settlement system and for whom disgorgement of funds could pose

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payment by a financial institution from avoidance. Payments, however, made by a financial institution that received a fraudulent transfer to an immediate transferee, *i.e.*, one of its customers, may be recovered from the immediate transferee pursuant to § 550. This reading of the statute is based on textual analysis that also happens to be entirely consistent with the legislative history of its enactment ("certain protections are necessary to prevent the *insolvency of one commodity or security firm* from leading to the insolvency of other firms and possibly threatening the collapse of the affected market"). H.R. Rep. No. 420, 97th Cong., 2d Sess. 261 (1982) (emphasis added).

a danger of insolvency and, therefore, substantial instability to that system?

Several federal courts have held that the term "settlement payment," and thus the scope of § 546(e), should be limited to common securities transactions and participants in such transactions that directly implicate the processes, and therefore the potential stability, of the securities clearing and settlement system. *Zahn*, 218 B.R. at 676-77; *KSC Recovery*, 168 B.R. at 1001; *Wieboldt*, 131 B.R 664-65; *see Jewel Recovery*, 196 B.R. 352-53 (holding that, because "private transaction which did not implicate the clearing and settlement process" would not have an impact on public market trading systems, § 546(e) should not apply to transaction). Those courts have held that transfers made to shareholders in the course of a tender offer in an LBO are not "settlement payments," the avoidance of which would cause upheaval in the securities industry. *Wieboldt*, 131 B.R. at 665; *see also Zahn*, 218 B.R. at 676.

In this case, the Third Circuit rejected Resorts' reliance on the reasoning of *Wieboldt*, *Jewel*, and *Zahn*, holding that "the term 'settlement payment' is a broad one that includes almost all securities transactions." App. at 20a. Instead of focusing on the effect that avoidance of the transaction at issue here would have on the clearance and settlement system of the securities industry or any of its protected participants, as counseled by the *Wieboldt* line of cases and the purpose that animated Congress' enactment of § 546(e), the Third Circuit purported to focus on whether the challenged transfer was a "common securities transaction." *Id.* Under that purely conclusory rubric, the court held that, "[d]espite the fact that payments to shareholders in an LBO are not the most common securities transaction, we see no absurd result from the

application of the statute's plain language and will not disregard it." App. at 22a.[13]

The circularity of the Third Circuit's analysis is self-evident. In this case, it is plain that requiring Lowenschuss to return the $4 million to Resorts for distribution to creditors pursuant to the system of priorities established by Congress in the *Code* did not have, and could not possibly have had, any impact whatever on Chase, on Merrill Lynch, or on the clearing and settlement system. In its analysis, the court implicitly acknowledged that the language of § 546(e) reaches only "common" securities transactions -- transactions that would have been understood by Congress in 1982 as needing some protection from the avoidance power of trustees in bankruptcy. The Congress that enacted §§ 546(e) and 741(8) in 1982 did not, however, leave the courts latitude to determine the reach of the term "settlement payment" based on their peculiar notions as to what might or might not be viewed as a "settlement payment" or a "common" securities transaction. Rather, Congress directed that this term of art be interpreted based on the common usage of this term "in the securities trade." § 741(8).

As previously noted, SEC Commissioner Longstreth's testimony in 1982 in favor of the enactment of § 546(e) in no way suggested that the swap of shares for cash in an LBO was the kind of "common" securities transaction that should come within the ambit of the proposed legislation. As Resorts will demonstrate on the merits, there is no evidence contemporaneous to the enactment

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[13] Whether an LBO is "not the most common securities transaction" begs the question presented, which is whether the term "settlement payment" as employed in § 546(e) includes the swap of securities for cash that occurs in an LBO.

of the 1982 amendments that would support the result reached by the Third and Tenth Circuits on this point and, indeed, the evidence is to the contrary.[14]

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14 The proper interpretation of "settlement payments," and the specific question whether that term embraces payments to tendering shareholders in LBOs, has been the focus of numerous commentaries that also testify to the clarity of the conflict, the disarray among the federal courts, and the great importance of the resolution of this conflict to bankruptcy practitioners and judges. *Compare* Neil M. Garfinkel, Note, *No Way Out: Section 546(e) is no Escape for the Public Shareholder of a Failed LBO*, 1991 Colum. Bus. L. Rev. 51; Gerald K. Smith & Frank R. Kennedy, *Fraudulent Transfers and Obligations: Issues of Current Interest*, 43 S.C. L. Rev. 709 (1992); William C. Rand, *In re Kaiser Steel Corporation: Does Section 546(e) of the Bankruptcy Code Apply to a Fraudulent Conveyance Made in the Form of an LBO Payment?*, 19 Fordham Urb. L.J. 87 (1991); and Jane Elizabeth Kiker, *Judicial Repeal of Fraudulent Conveyance Laws; Kaiser Steel Corp. v. Charles Schwab & Co., 913 F.2d 846 (10th Cir. 1990)*, 14 Hamline L. Rev. 453 (1991) (all concluding that payments to selling shareholders in an LBO are not "settlement payments"), with Michael Cook, et al., *The Judicially Created "Innocent Shareholder" Defense to Constructive Fraudulent Transfer Liability in Failed Leveraged Buyouts*, 43 S.C. L. Rev. 777, 801, 804 (1992) (finding *Kaiser* analysis "tenable," but noting that "insulating payments that are made to public shareholders from fraudulent transfer attack arguably does nothing to promote stability" in the clearance and settlement system).

D. The undeniable conflicts presented by this petition are ripe for this Court's review and resolution

On January 12, 1998, the Court denied review of *Munford*. Six weeks later, the District Court for the District of Rhode Island decided *Zahn*, squarely holding, as had *Munford*, that the payments there had not been made "by or to" a protected entity under § 546(e).[15] In that same decision, the District Court flatly held that payments identical to those at issue here are not "settlement payments" as that term is used in § 546(e). In this case, of course, the Third Circuit not only rejected *Munford*'s holding but those of *Zahn*, *Wieboldt* and *Jewel*. It is understatement to say that the lower federal courts are in disarray on these points of bankruptcy law.

In a brief filed in this Court in *Munford* at the certiorari stage by the Securities and Exchange Commission,[16] the Commission took the position that *Munford* presented issues "that

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[15] In *Zahn*, the intermediary was literally not an entity named in § 546(e), but it performed precisely the same function as was performed by Chase in the case at bar -- accepting the tendered shares and acting as paying agent in the distribution of the cash back to the shareholders. Refusing to elevate form over substance, *Zahn* refused to apply § 546(e) on those facts because doing so would "sanction the practice of structuring private stock purchases in an effort to circumvent the avoidance section, merely by utilizing a financial institution." 218 B.R. at 677 (quoting *Jewel*, 196 B.R. at 353).

[16] The Commission participated in *Munford* in the Eleventh Circuit under 11 U.S.C. § 1109(a). The Commission did not participate in the case at bar.

may at some point call for this Court's review and correction."[17] The Commission, having supported the *Munford* petitioners on the merits in the Eleventh Circuit, renewed that support in this Court and noted that, "[i]f widely adopted and applied, [*Munford*] could undermine the effectiveness of Section 546(e) . . . ."[18] Nonetheless, the Commission urged that these issues were not "presently ripe for review"[19] because the "conduit" argument had not yet been addressed by any other court of appeals and thus there was no conflict at that level.[20]

The Third Circuit has now provided the direct conflict missing from the Court's consideration and denial of the *Munford* petition in January 1998. The inter-circuit conflict has matured, and as exemplified by *Zahn*, federal district courts in the First (*Zahn* and *Heathco*), Fifth (*Jewel*) and Seventh (*Wieboldt*) Circuits are aligned with the *Munford* camp, and it would seem that the Second Circuit (*Finley, Kumble*) will necessarily join that camp.[21]

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[17] Brief for the Securities & Exchange Commission at 6.

[18] *Id.* at 8.

[19] *Id.* at 6.

[20] *Id.* at 8.

[21] The *Munford* court held that where a financial institution is "nothing more than an intermediary or conduit" for LBO payments to shareholders, it is not a "transferee" under 11 U.S.C. § 550, 98 F.3d at 610 (citing *In re Chase & Sanborn Corp.*, 848 F.2d at 1200), and hence, § 546(e) has no application. Similarly, the Second Circuit -- in a fraudulent transfer case, squarely adopted *Chase & Sanborn* in holding

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The Third Circuit's camp is not, of course, without support in the Tenth (*Kaiser I* and *II*) and Ninth (*Comark*) Circuits. Although there may be some differences in the facts from case to case, such differences as may exist do not appear to affect the decisions of courts opting for one camp or the other.

If this Court does not act now to resolve these conflicts over the proper interpretation of § 546(e), it will encourage, if not require, bankruptcy trustees throughout the Nation to bring LBO fraudulent transfer actions against former shareholders in courts in the Eleventh Circuit (or other similarly inclined circuits, such as the Second and Seventh, *see* note 20 *supra)*, whenever personal jurisdiction can be established there over former shareholders. This Court has held that a trustee "has the duty to maximize the value of the estate." *Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 352 (1985). Furthermore, a trustee is directed by statute to "investigate the acts, conduct, assets, liabilities, and financial condition of the debtor," *Code* § 1106(a)(3), and to "collect and reduce to money the property of the estate for which such trustee serves." *Code* § 704(1).

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that when a "commercial entity . . . acts as a mere conduit for funds . . . [it] is not an initial transferee within the meaning of § 550(a)(1)." *In re Finley, Kumble, et al.*, 130 F.2d at 59. Thus, it is to be expected that when the Second Circuit is faced with a § 546(e) defense to a fraudulent transfer action brought against former shareholders involved in an LBO, that court would follow the holding of the Eleventh Circuit in *Munford.* The same would appear to hold true in the Seventh Circuit, *see Bonded Fin. Servs. v. European Am. Bank*, 838 F.2d at 893, upon which the *Finley, Kumble* court relied. 130 F.2d at 57-58.

A debtor in possession generally bears these obligations as well. *Weintraub*, 471 U.S. at 355 ("if a debtor remains in possession . . . the debtor's directors bear essentially the same fiduciary obligation . . . as would the trustee for a debtor out of possession."). This obligation to pursue former shareholders in the Eleventh Circuit -- at least where jurisdiction can be obtained in that circuit -- will be the same for every bankruptcy trustee no matter where the underlying bankruptcy case is pending, because a trustee or debtor in possession may "commence and prosecute any action or proceeding in behalf of the estate before any tribunal." Fed. R. Bankr. P. 6009. Thus, the rights and obligations of shareholders and creditors will depend in any particular case on the availability of venue in the Eleventh Circuit for an action by a trustee to recover assets of the estate paid out to shareholders in an LBO transaction. Such "forum shopping" is peculiarly troublesome in the bankruptcy context because of the interconnection of businesses across state and regional lines and the consequent need for uniformity.

Finally, the Solicitor General not infrequently seeks review by this Court of decisions of the Courts of Appeals interpreting the *Code* that are in conflict out of recognition that uniformity of decision in this area is of unusual importance to a regime that sees the *Code* invoked well over one million times each year in the filing of actions in the bankruptcy courts. As the Solicitor General recently put the matter in supporting this Court's review of a case to which neither the United States nor a federal agency was a party, "recurring conflict leads to uncertainty and wasteful litigation." *See* Brief for the United States as Amicus Curiae Supporting Petitioner at 13, *Citizens Bank of Maryland v. Strump*, 516 U.S. 16 (1995). And, as the Solicitor General pointed out, the problems faced by participants in the bankruptcy process -- whether creditor or debtor or other party in interest -- do not arise simply from a particular inter-circuit conflict: "[I]n the circuits where a clear answer has not yet been provided, creditors can only speculate . . . ." *Id.*

Indeed, the Solicitor General has not shrunk from supporting this Court's review even in cases in which the federal respondent -- represented by the Solicitor General in this Court -- had prevailed on the merits in the Court of Appeals. Thus, the Solicitor General urged (successfully) that a petition be granted in order to secure uniform application of the bankruptcy law where, *inter alia*, "it does not appear likely that the lower courts will reach a unanimous view on the question." Brief for the Federal Respondent at 9, *BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994). Given the flat rejection of the Third Circuit's decision in this case by the District Court in *Zahn* -- the only other case raising this question to have been decided since this Court denied review in *Munford,* as well as the differing approaches of several of the circuit courts in cases raising a similar, but not identical, question, *see* note 20 *supra* -- it seems unlikely in the extreme that this question will ever be resolved uniformly by the federal courts absent the intervention of this Court.[22]

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[22] Although the Solicitor General acted as counsel to the Securities and Exchange Commission in *Munford* and the Commission took a position on the merits contrary to this petitioner, we note that it was the position of the Commission, not the United States, that was before the Court in that case. As the Court is aware, the United States and its agencies (including the Internal Revenue Service and the Pension Benefit Guaranty Corp.) frequently are party to bankruptcy proceedings as creditors. Because virtually any creditor in any bankruptcy proceeding could be expected to benefit from the successful exercise of power by a trustee to recover assets of a bankrupt's estate, the United States clearly has an interest in the resolution of this question no matter what position the United States might take on the merits.

CONCLUSION

For the reasons set forth above, petitioner respectfully asks this Court to grant the petition for a writ of certiorari and set this case for plenary consideration and disposition.

Dated: September 28, 1999

Respectfully submitted,

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APPENDIX

APPENDIX A

Filed June 30, 1999

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 98-6037

IN RE: RESORTS INTERNATIONAL, INC.,
RESORTS INTERNATIONAL FINANCING INC.,
GRIFFIN RESORTS INC., and
GRIFFIN RESORTS HOLD, INC.,
Debtors

FRED LOWENSCHUSS, individually and as
Trustee of FRED LOWENSCHUSS, I.R.A.,
LAURANCE LOWENSCHUSS, I.R.A., and
FRED LOWENSCHUSS ASSOCIATES PENSION PLAN
v.
RESORTS INTERNATIONAL, INC.
Sun International North America, Inc.,
which was formerly known as
Griffin Gaming & Entertainment, Inc.,
which was formerly known as
Resorts International, Inc.,
Appellant

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY
(D.C. No. 97-cv-04710)
District Judge: The Honorable Nicholas H. Politan

ARGUED JANUARY 14, 1999
BEFORE: Nygaard, Alito, and Lewis, *Circuit Judges.*
(Filed June 30, 1999)

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OPINION OF THE COURT

NYGAARD, *Circuit Judge:*

Resorts International, Inc., now Sun International North America, Inc., ("Resorts") appeals a District Court order reversing a Bankruptcy Court order that awarded Resorts full restitution for losses resulting from a stock transaction. The Bankruptcy Court found for Resorts on the alternative grounds of mistake and fraud. We will affirm the District Court's reversal.

I.

The relevant facts are generally undisputed and we need only summarize. Fred Lowenschuss was a shareholder of Resorts

stock.[1] In 1988, Griffco Acquisition Corporation (owned by Merv Griffin) purchased Resorts in a leveraged buyout for $36 per share. Resorts sent a proxy statement to all its shareholders that explained the terms of the merger and stated that the shareholders had the right to receive $36 per share or to seek appraisal rights in the Delaware courts.

Ultimately, the merger was approved by the Delaware Chancery Court and consummated. Resorts then sent a "Notice of Merger of Griffco Acquisition Corp. With and Into Resorts International Inc.," and a "Transmittal Letter" to shareholders, explaining that they could either tender their shares and receive $36 per share or obtain an appraisal under section 262 of the Delaware Corporation Law. Lowenschuss sent Resorts a letter demanding an appraisal.

He then filed an appraisal action in the Eastern District of Pennsylvania. One week later, Resorts petitioned for appraisal in Delaware Chancery Court, identifying Lowenschuss as a shareholder seeking appraisal. The federal District Court dismissed Lowenschuss's claim without prejudice, deferring to the

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[1] Fred Lowenschuss was the original defendant in this case. He held a total of 105,900 shares of Resorts stock both as an individual and as trustee for the Fred Lowenschuss IRA, the Laurance Lowenschuss IRA, and the Fred Lowenschuss Associates Pension Plan (the holder of most of the shares in question). Before the November 1996 trial, Fred's son, Laurance Lowenschuss, became the trustee of the Pension Plan, and the Bankruptcy Court severed the claims against Fred Lowenschuss individually and as a trustee. Laurance Lowenschuss, the current trustee of the Pension Plan and of the Laurance Lowenschuss IRA, is litigating this appeal. For simplicity, we will refer to Appellees simply as "Lowenschuss."

proceedings in Delaware. *See Lowenschuss v. Resorts Int'l, Inc.*, No. Civ.A.89-1071 (E.D. Pa. June 29, 1989).

The Delaware Chancery Court issued a "Notice of Entitlement to Appraisal," explaining that shareholders seeking appraisal must "deliver [their] stock . . . certificates to the Register in Chancery within sixty (60) days of this notice [or risk] dismissal of the appraisal proceedings as to [the] shares." *In re Appraisal of Resorts International, Inc.*, No. Civ.A.10626 (Del. Ch. May 31, 1989). Lowenschuss never delivered his shares. Instead, he filed an amended complaint in the Eastern District of Pennsylvania against Resorts and others, moving for reconsideration of his request for an appraisal of the shares under his control. The District Court dismissed this action without prejudice, again because of the Delaware Chancery Court proceedings.

This dispute involves the next moves by Lowenschuss. First, he filed (again in the Eastern District of Pennsylvania) a "Petition Requiring Resorts . . . to Pay $36.00 Merger Price to Plaintiffs Immediately for 105,900 Shares of Resorts Class A Stock Owned by Plaintiffs and Which Are Hereby Being Tendered and to Complete the Record." In the Petition, he stated: "Plaintiffs are hereby tendering all of their Resorts International, Inc. Class A shares totaling One hundred and Five thousand Nine hundred (105,900) shares for immediate payment of the merger price of Thirty-six Dollars ($36.00) per share plus the interest which plaintiffs may be entitled to."

Then, four days later, Lowenschuss tendered his shares, which were clearly marked as his, to Merrill Lynch, his broker, who in turn tendered them to Chase Manhattan Bank, Resort's Transfer Agent for the merger. As it regularly did, Chase forwarded a list of the tendering shareholders to Resorts and asked Resorts to wire funds to the payment account. Approximately two weeks after the tender, Resort's treasurer authorized the transfer of funds to Chase. Chase then delivered a check to Merrill Lynch for $3,805,200.00, which was paid over to Lowenschuss. Subsequently, the District Court denied Lowenschuss's Petition

See Lowenschuss v. Resorts Int'l, Inc., No. Civ.A.89-1071 (E.D. Pa. Aug. 3, 1989).

When Resorts realized that it had paid Lowenschuss the merger price, it filed this suit seeking to recover the payment. Following the initiation of Resort's Chapter 11 reorganization in New Jersey, this case was removed from the Eastern District of Pennsylvania to the Bankruptcy Court for the District of New Jersey. Resorts sought restitution of the transferred funds, claiming that the payment was (1) the result of a mistake by a Resorts employee, (2) a product of fraud, (3) contrary to Delaware corporate law, and (4) an avoidable transfer by a bankrupt entity under federal and New Jersey law. The Bankruptcy Court awarded Resorts full restitution on the alternative grounds of mistake and fraud, and appeared also to rely on the doctrine of illegal contracts and *in pari delicto*. *See In re: Resorts International*, Nos. 89-10119; 89-10120; 89-10461; 89-10462; Adv. No. 90-1005 (Bankr. D.N.J. Apr. 22, 1997) (slip opinion, hereinafter "*Resorts* I").

On appeal, the District Court reversed the Bankruptcy Court's ruling, concluding, *inter alia*, that there was no mistake of fact and that Resorts did not reasonably rely upon any misrepresentation. *See In re: Resorts Int'l, Inc.*, No. Civ.A.97-4710 (D.N.J. Mar. 26, 1998) (unpublished letter opinion, hereinafter "*Resorts* II"). Resorts now appeals the District Court's decision, alleging that the court erred by overturning the Bankruptcy Court's holdings that: (1) Lowenschuss committed fraud; (2) Resorts made a mistake of fact; and (3) an illegal contract existed and the parties were not *in pari delicto*. Resorts also reasserts that the transaction is avoidable as a fraudulent conveyance under federal and state law. Finally, Lowenschuss contends that the Bankruptcy Court lacked jurisdiction.

We exercise plenary review over the decision of a district court sitting as an appellate court in a bankruptcy proceeding. *See In re Swedeland Dev. Group, Inc.*, 16 F.3d 552, 559 (3d Cir. 1994) (en banc). As a result, our review is essentially a direct review of

the ruling of the Bankruptcy Court. *See Allegheny Int'l Inc. v. Snyder (In re Allegheny Int'l Inc.),* 954 F.2d 167, 172 (3d Cir. 1992). We review the Bankruptcy Court's findings of fact for clear error and its conclusions of law *de novo. See In re Sharon Steel Corp.,* 871 F.2d 1217, 1222-23 (3d Cir. 1989).

II.

Resorts now asserts that it should have prevailed at trial on three common law theories — fraud, mistake, and illegal contract.

A. Fraud

The Bankruptcy Court concluded that Lowenschuss defrauded Resorts of the payment for his shares. To establish a prima facie case for fraud under New Jersey law,[2] Resorts was required to prove: (1) that Lowenschuss made a material misrepresentation of a presently existing or past fact, (2) which he knew or believed to be false, (3) upon which he intended Resorts to rely, (4) and upon which Resorts reasonably did rely, (5) with resulting damages. *See Jewish Ctr. v. Whale,* 432 A.2d 521, 524 (N.J. 1981). Moreover, it had to prove each element by clear and convincing evidence. *See Stochastic Decisions, Inc. v. DiDomenico,* 565 A.2d 1133, 1137 (N.J. Super Ct. App. Div. 1989).

We review the trial court's factual findings related to the fraud claim for clear error, keeping in mind the heightened "clear and convincing" standard. *See, e.g., United States v. Bertoli,* 40 F.3d 1384, 1411 (3d Cir. 1994) (some "speculation [might] survive[] scrutiny under the preponderance of the evidence standard, [but] it certainly cannot withstand scrutiny under the

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2 The parties agree that New Jersey law governs this issue.

clear and convincing evidence standard"); *see also E.E.O.C. v. Local 638,* 81 F.3d 1162, 1174 (2d Cir. 1996) (the clearly erroneous standard of review is more stringent when applied to a trial court's finding that had to meet the "clear and convincing" standard).

The District Court reversed the Bankruptcy Court, holding that it had misconstrued the significance of the various legal filings in question in finding a material misrepresentation, the facts did not support a finding of reliance, and, even if Resorts did rely on a misrepresentation, reliance was not reasonable. We agree because the evidence simply does not provide "clear and convincing" proof of reasonable reliance.[3]

A finding of reliance is subject to review for clear error, *see, e.g., Hong Kong Deposit & Guar. Co. v. Shaheen,* 111 B.R. 48, 52 (S.D.N.Y. 1990), and a trial court may infer reliance from the various facts and circumstances of a case. *See Knop v. McMahan,* 872 F.2d 1132, 1142 (3d Cir. 1989). Again, this element required proof by clear and convincing evidence.

The Bankruptcy Court considered the testimony of Resorts' former General Counsel, who stated that he understood at the time of Lowenschuss's tender that Lowenschuss had declined the merger price and was seeking a remedy in court. The General Counsel testified that it "[n]ever occurred to [him] that anyone would invoke the appraisal rights and seek to be paid." Based solely upon this testimony, the Bankruptcy Court held that: "Resorts reliance was both reasonable and justifiable given the

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[3] Although we are not convinced that the District Court erred by holding that Lowenschuss's filings in this matter did not provide clear and convincing evidence of material misrepresentations, we need not resolve the issue because reasonable reliance was clearly lacking.

Trustee's numerous misrepresentations . . . that he was seeking a judicial remedy." *Resorts* I, at 49.

Although Lowenschuss may have sought judicial relief to receive the original merger price, this could not signify to Resorts that he would not also tender his shares to the company. Because Lowenschuss was seeking to be allowed to tender his shares for payment of the merger price, it was certainly plausible that he would attempt to perform any necessary acts on his part, including tendering his shares.

Courts often impose a stricter standard of reasonable reliance on sophisticated business persons. *See Vanguard Telecomm., Inc. v. Southern New England Tel. Co.*, 900 F.2d 645, 655 (3d Cir. 1990). Even absent a stricter standard, however, Resorts' actions reveal no reliance whatsoever because they demonstrate that Resorts established a system that would blindly pay all shareholders, even those who had sought an appraisal. Thus, Lowenschuss could have tendered his shares and been paid even if he never filed either of the claims to which the Bankruptcy Court referred.

The District Court considered the Bankruptcy Court's finding that Resorts "failed to exercise reasonable care" when it authorized payment to Lowenschuss, *Resorts* II, at 19-22 (quoting *Resorts* I, at 33), to determine that any reliance by Resorts was not reasonable. In particular, the Bankruptcy Court found that

> Resorts failed to exercise reasonable care when it authorized payment to Lowenschuss . . . . Resorts breached its duty to adequately supervise the surrender of shares . . . by failing to make even a cursory investigation as to the identity of the tendering shareholder and whether that shareholder had previously sought appraisal rights.
>
> The record further demonstrates that Chase identified the [Lowenschuss] Pension Plan and I.R.A. as tendering shareholders in a transfer journal sheet dated July 26, 1989,

> some five days before the date Resorts authorized payment for the shares. Resorts failed to provide a list of appraisal shareholders to the employees responsible for payment upon surrender of the shares, nor did Resorts provide such a list to Chase. Even after learning of the illegal payment to Lowenschuss, Resorts failed to issue corrected instructions to Chase to cease all payments to appraisal shareholders who failed to obtain the requisite approvals . . . . Resorts paid other appraisal shareholders, even after Resorts' counsel notified Lowenschuss of his intent to recover the funds paid to Lowenschuss.

Resorts I, at 33-34.

Knowing that Lowenschuss was seeking to be paid the merger price, Resorts should have, at the very least, reviewed the lists of tendering shareholders or contacted the court to determine whether it had custody of the shares. Nevertheless, Resorts did nothing. As a result, there simply was no reliance, reasonable or otherwise, by Resorts. The fraud claim, therefore, was properly rejected by the District Court.[4]

B. Mistake

Resorts next asserts that the District Court erred by reversing the Bankruptcy Court's ruling that Resorts made a mistake of fact. The Bankruptcy Court discussed Resorts' assertions that it was mistaken as to both fact and law; the former from its failure to recognize that it was Lowenschuss tendering the shares, and the latter from its belief that it was legally bound to pay

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[4] Because we hold that there was not sufficient evidence of reasonable reliance, we need not address the remaining elements of the fraud claim.

Lowenschuss when he tendered. *See Resorts* I, at 25-28. Although the court then apparently concluded that Resorts had made a mistake of fact, its discussion of the issue relates to the alleged legal mistake. The Bankruptcy Court stated:

> Here the Court finds that Resorts made a mistake of fact. Resorts' employees including its former treasurer, Thomas O'Donnell, and its Chief Financial Officer, Matthew B. Kearney mistakenly believed that Resorts was obligated to pay $36.00 for all Resorts shares tendered.

Id. at 28. Later, the Bankruptcy Court appeared to grant Resorts relief for its mistake: "[Lowenschuss] committed several wrongs apart from the illegality of the transaction. Accordingly, as this Court finds that Resorts made the payment as the result of a mistake, Resorts is entitled to restitution." *Id.* at 43. The court's analysis of this claim, however, included a discussion of the doctrine of illegal contract and *in pari delicto*. *See* Part II.C, *infra*.

The District Court noted, and Resorts concedes, that if Resorts made the payment under the misapprehension that it was legally required to, Resorts made a classic mistake of law. Not surprisingly, Resorts now reasserts that it made both a mistake of law and a mistake of fact and that it should prevail under either theory.

1. Mistake of Law

Notwithstanding the Bankruptcy Court's finding, Resorts' first assertion on appeal is that it made a unilateral mistake of law "based on the erroneous belief that the company was required to accept the tender of shares that were subject to an appraisal proceeding." Appellants' Br. at 38. However, it is a

> settled principle of [New Jersey] law that where an individual under a mistake of law, but with full knowledge of the facts,

> voluntarily pays money on a demand not legally enforceable against him, he cannot recover it in the absence of unjust enrichment, fraud, duress or improper conduct on the part of the payee.

Messner v. County of Union, 167 A.2d 897, 898 (N.J. 1961). Resorts contends that it may recover under this theory because the Bankruptcy Court found sufficient "improper conduct" on Lowenschuss's part to allow for recovery.

We reject this contention because Resorts' action did not result from ignorance or a mistake of law. Resorts' full knowledge of the law is evidenced by its response to Lowenschuss's Petition. In the response, filed over a week before Resorts authorized the payment for Lowenschuss's shares, the company argued that the request for payment was "contrary to the controlling Delaware statute." Far from being mistaken as to any relevant law, Resorts was simply careless in entering into this contract by paying Lowenschuss for his shares when it may not have been obligated to.

2. Mistake of fact

For similar reasons, Resorts cannot recover by contending that it was operating under a mistake of fact as to the identity of the tenderer (Lowenschuss). We first note that a "unilateral mistake of a fact unknown to the other party is not ordinarily grounds for avoidance of a contract," and that, in order to grant rescission in the case of a factual mistake, "the mistake must have occurred notwithstanding the exercise of reasonable care by the party making the mistake." *Intertech v. City of Paterson*, 604 A.2d 628, 632 (N.J. Super. Ct. App. Div. 1992).

The Bankruptcy Court and District Court both found that Resorts failed to act with reasonable care. We agree. Resorts' ignorance was self-imposed. It could easily have determined that Lowenschuss was tendering the shares because a list of tendering

shareholders with his name on it was forwarded to Resorts before it authorized the payments. Nevertheless, the company chose not to review the list. As a result, Resorts' failure to realize that Lowenschuss had tendered his shares was of its own doing, and it cannot recover under this theory.

C. Illegal contract

As noted, the Bankruptcy Court interwove its discussion of mistake with a discussion of illegal contract and the doctrine of *in pari delicto*. In addition to the mistake analysis, the court appeared to find for Resorts under the illegal contract doctrine, holding that it deserved restitution because it was not *in pari delicto* with Lowenschuss.

The doctrine of *in pari delicto* normally applies as a common law defense against a party seeking to enforce an illegal contract. "In pari delicto potior est conditio defendentis" means that "[i]n a case of equal or mutual fault . . . the position of the [defending] party . . . is the better one." Black's Law Dictionary 791 (6th ed. 1990). Here, Resorts seeks to use the doctrine to gain restitution for its payment to Lowenschuss.

Resorts' argument runs counter to New Jersey's law, that courts will leave the parties to an executed illegal contract as they are. *See, e.g., Marx v. Jaffe*, 222 A.2d 519, 521 (N.J. Sup. Ct. App. Div. 1966); *Paley v. Barton Sav. & Loan Ass'n*, 196 A.2d 682, 685 (N.J. Super. Ct. App. Div. 1964). Courts on occasion, however, apply an equitable exception to this general rule when the parties are not *in pari delicto*. *See, e.g., Singleton v. Foreman*, 435 F.2d 962, 969 (5th Cir. 1970) (recognizing such an exception in Florida law). New Jersey courts give "a traditional construction to the defense," *McAdam v. Dean Witter Reynolds, Inc.*, 896 F.2d 750, 757 (3d Cir. 1990) (citing *Pendleton v. Gondolf*, 96 A. 47 (N.J. Ch. Ct. 1915)), and have found a party to an illegal agreement deserving of equitable relief because he was not *in pari delicto* with the other party to the agreement. *See Appel v. Reiner*, 195

A.2d 310, 317-18 (N.J. Super Ct. Ch. Div. 1963), *rev'd on other grounds*, 204 A.2d 146 (N.J. 1964). The Bankruptcy Court treated the doctrine as part of New Jersey law and applied it here.

In its pre-trial ruling on the cross-motions for summary judgment, the Bankruptcy Court held that the transaction by which Lowenschuss tendered his shares and Resorts paid him for them constituted an illegal contract because the tender of the shares was contrary to Delaware Corporation Law § 262.[5] The court held

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[5] Section 262 sets forth the rights and obligations of shareholders seeking an appraisal in lieu of payment for their shares following a merger. Lowenschuss voted against the merger and timely requested an appraisal, thereby securing the right to an appraisal. *See* Del. Code Ann. tit. 8, § 262(d). Subsection (e) allows the withdrawal of an appraisal demand and acceptance of the merger terms "at any time within 60 days after the effective date of the merger." *Id.* § 262(e). Lowenschuss, however, did not withdraw his request for appraisal within 60 days of the merger.

The statute also provides for withdrawals that occur more than sixty days after the merger:

> (k) From and after the effective date of the merger or consolidation, no stockholder who has demanded his appraisal rights as provided in subsection (d) of this section shall be entitled to vote such stock for any purpose or to receive payment of dividends or other distributions on the stock . . . ; provided, however, that . . . if such stockholder shall deliver to the surviving or resulting corporation a written withdrawal of his demand for an appraisal and an acceptance of the merger or consolidation, either within 60 days after the effective date

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open the possibility that it might later find that the parties were not *in pari delicto*, and award Resorts the equitable remedy of restitution on this basis.

Following trial, the court found that Lowenschuss's misrepresentations, apart from the illegal transaction, prevented him from being *in pari delicto* with Resorts and ordered restitution in the amount of the transaction on this basis. *See Resorts* I, at 37-43. If the relative guilt of the parties is a primarily factual determination, then a trial court's finding of such is reviewed for clear error. *See Rothberg v. Rosenbloorn*, 808 F.2d 252, 260 (3d Cir. 1986) (Seitz, J., concurring).

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> of the merger . . . as provided in subsection (e) of this section *or thereafter with the written approval of the corporation, then the right of such stockholder to an appraisal shall cease.* Notwithstanding the foregoing, no appraisal proceeding in the Court of Chancery shall be dismissed as to any stockholder without the approval of the Court, and such approval may be conditioned upon such terms as the Court deems just.

Id., § 262(e), (k) (emphasis added). Thus, section 262 requires a shareholder who has sought appraisal to get the corporation's written approval and the court's approval in order to withdraw his demand for appraisal more than 60 days after the date of the merger. The merger closed on November 15, 1988, and Lowenschuss did not tender his shares until July 17, 1989. Lowenschuss did not obtain Resorts' written approval of his withdrawal demand before tendering his shares. Therefore, his tender was contrary to the statute and, at least arguably, created an illegal contract.

The Bankruptcy Court, however, was construing Lowenschuss's legal maneuvers to conclude that Lowenschuss was not *in pari delicto* with Resorts. The court noted: (1) that Lowenschuss tendered the shares knowing that they were subject to the appraisal action in Delaware; and (2) that after he tendered his shares, Lowenschuss failed to notify Resorts or the Pennsylvania District Court of the tender. *See Resorts* I, at 40-41. Although Lowenschuss may well have known that his tender was questionable, we agree with the District Court's conclusion that he was not more responsible for the mistaken payment than Resorts.

Resorts' Notice of Merger and Letter of Transmittal indicated that it would pay the merger price to shareholders who had previously requested appraisal. Although the Bankruptcy Court did not credit Lowenschuss's testimony that he relied on the Letter of Transmittal in tendering his shares, *see Resorts* I, at 37, the notice indicates that Resorts, like Lowenschuss, was acting inconsistently with section 262. In sum, Lowenschuss and Resorts were both to blame for the resulting transaction and were *in pari delicto*. The District Court correctly rejected this doctrine as a basis for recovery.

III.

Resorts next asserts that the transaction is avoidable as a fraudulent conveyance under 11 U.S.C. § 548(a)(1)(B).[6]

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[6] The briefs refer to 11 U.S.C. § 548(a)(2); however, under the current code, the relevant section is 548(a)(1)(B). Section 548 was amended in 1998, and subsection 548(a)(2) now refers to transfers of charitable contributions.

Resorts also asserted a similar claim under N.J. Stat. Ann. §§ 25:2-25(b)(1) and 25:2-27(a). It now states, and we

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A. Section 548(a)(1)(B) avoidable transfers

Section 548(a)(1)(B) allows bankruptcy debtors to avoid some transactions completed before the bankruptcy filing. It states:

> The trustee may avoid any transfer of an interest of the debtor in property . . . that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily . . . received less than a reasonably equivalent value in exchange for such transfer or obligation; and . . . was insolvent on the date that such transfer was made.

11 U.S.C. §548(a)(1)(B). It is not disputed that the transaction took place less than a year before Resorts' bankruptcy filing. Thus, if Resorts received less than a reasonably equivalent value to the $3,800,000 it paid and was insolvent on the date of the transfer to Lowenschuss, then section 548 would allow the trustee to avoid the transfer.[7]

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> accept, that the analysis of the federal and state laws is practically identical, and therefore separate analysis of the state claim is not necessary.

[7] The Bankruptcy Court recited evidence that Resorts was insolvent when it paid Lowenschuss (including the fact that prior to making the payment, Lowenschuss had encouraged a group of Resorts shareholders to put the company into bankruptcy). *See Resorts* 1, at 18-22. The court did not, however, make factual findings on this issue or the issue of reasonably equivalent value. Instead, the court assumed the

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B. The section 546(e) exception

Section 546(e) provides an exception to the rule of section 548(a)(1)(B), preventing its operation when the payment in question was a securities "settlement payment." Section 546(e) states:

> Notwithstanding section[] ... 548(a)(1)(B) ... of this title, the trustee may not avoid a transfer that is a ... settlement payment, as defined in section 101 or 741 of this title, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency, that is made before the commencement of the case ....

Id. §546(e).[8]

The issue is whether the Bankruptcy Court erred by holding that Resorts' payment to Lowenschuss was a "settlement payment," and that section 546, therefore, barred the application of section 548(a)(1)(B). Section 741 defines "settlement payment" as "a preliminary settlement payment, a partial settlement payment,

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existence of these elements and applied section 546(e) of the code. Because we determine that section 546(e) controls the outcome here, we need not address these factors.

8 The exception does not apply to transfers that are avoidable under section 548(a)(1)(A), which requires, *inter alia*, a showing that a transfer was made with the intent to defraud creditors. That is clearly not the case here.

an interim settlement payment, a settlement payment on account, a final settlement payment, *or any other similar payment commonly used in the securities trade." Id.* § 741(8) (emphasis added). Section 101 provides a similar definition, but limits it to payments used in the forward contracts trade. *See id.* § 101(51A).

In *Bevill, Bresler & Shulman Asset Management Corp. v. Spencer Savings & Loan Ass'n,* 878 F.2d 742 (3d Cir. 1989), we addressed the meaning of "settlement payment" under section 546(f) in a securities transfer under "repo" agreements. Section 546(f) is similar to section 546(e) except that it applies specifically to settlement payments made "by or to a repo participant in connection with a repurchase agreement." 11 U.S.C. § 546(f). In *Bevill,* we noted that section 546 is at the intersection of "two important national legislative policies . . . on a collision course"—the policies of bankruptcy and securities law. 878 F.2d at 751. We stated that the "extremely broad," *id.,* statutory definition of "settlement payment" is consistent with Congress's intent:

> that a "settlement payment" may be the deposit of cash by the purchaser or the deposit or transfer of the securities by the dealer, and that it includes transfers which are normally regarded as part of the settlement process, whether they occur on the trade date, the scheduled settlement day, or any other date in the settlement process for the particular type of transaction at hand.

Id. at 752. Our prior recognition that the definition is extremely broad indicates that it is likely to encompass the instant transaction. *Bevill,* however, did not consider payments made pursuant to a leveraged buyout ("LBO"), and therefore does not definitively determine the outcome here.

We begin every statutory interpretation by looking to the plain language of the statute. *See Idahoan Fresh v. Advantage Produce, Inc.,* 157 F.3d 197, 202 (3d Cir. 1998). When the

language is clear, no further inquiry is necessary unless applying the plain language leads to an absurd result. *See id.*

In the securities industry, a settlement payment is generally the transfer of cash or securities made to complete a securities transaction. *See Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846, 849 (10th Cir. 1990) (citing various securities industry texts). Here, the securities passed from Lowenschuss's broker, Merrill Lynch, to the transfer bank, Chase Manhattan. Resorts wired funds to Chase which Chase then forwarded them to Merrill Lynch who paid Lowenschuss. Although no clearing agency was involved in this transfer, two financial institutions — Merrill Lynch and Chase — were. Under a literal reading of section 546, therefore, this was a settlement payment "made by . . . a financial institution." 11 U.S.C. § 546(e).

A number of district courts have held that the term "settlement payment" does not include payments made for shares by a corporation as part of an LBO. *See, e.g., Zahn v. Yucaipa Capital Fund*, 218 B.R. 656, 675 (D.RI. 1998); *Wiebolt Stores, Inc. v. Schottenstein*, 131 B.R. 655, 664-65 (N.D. Ill. 1991). The reasoning of these courts is essentially that "the system of intermediaries and guarantees" that normal securities transactions involve is not in play in an LBO. *See Zahn*, 218 B.R. at 676.

The only other court of appeals to directly address this question, however, followed a *Bevill* analysis and held that payments to shareholders as part of an LBO were "settlement payments" under the statute. *See Kaiser Steel Corp. v. Pearl Brewing Co.*, 952 F.2d 1230, 1239-40 (10th Cir. 1991);[9] *see also In re Comark*, 971 F.2d 322, 325 (9th Cir. 1992) (citing *Kaiser*

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[9] Resorts argues that *Kaiser Steel* is inapposite because the transactions therein involved a clearing agency; however, some of the transactions also were made through a financial institution. *See Kaiser Steel*, 952 F.2d at 1240.

approvingly for the proposition that "a settlement is 'the completion of a securities transaction'"). The general thrust of *Kaiser Steel, Bevill* and *In re Comark* is that the term "settlement payment" is a broad one that includes almost all securities transactions. Including payments made during LBOs within the scope of the definition is consistent with the broad meaning these cases discern. A payment for shares during an LBO is obviously a common securities transaction, and we therefore hold that it is also a settlement payment for the purposes of section 546(e).[10]

Resorts alternatively encourages us to follow *Munford v. Valuation Research Corp.*, 98 F.3d 604, 610 (11th Cir. 1996), in which the Eleventh Circuit Court of Appeals considered the application of section 546 to similar payments made to shareholders in an LBO. The two judges in the majority found it unnecessary to determine whether the payments were settlement payments under section 546, holding that even if they were,

> section 546(e) is not applicable unless the transfer (or settlement payment) was "made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency." 11 U.S.C. § 546(e). . . .
>
> True, a section 546(e) financial institution was presumptively involved in this transaction. *But the bank here was nothing more than an intermediary or conduit. Funds were deposited with the bank and when the bank received the*

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10 Despite this logical conclusion, a number of commentators have criticized *Kaiser Steel* for applying section 546 to a transaction that did not implicate the concerns that Congress had in creating the law. *See, e.g,* Frank R. Kennedy & Gerald K. Smith, *Fraudulent Transfers and Obligations: Issues of Current Interest,* 43 S.C. L. Rev. 709 (1992).

> *shares from the selling shareholders, it sent funds to them in exchange. The bank never acquired a beneficial interest in either the funds or the shares.*

Munford, 98 F.3d at 610 (emphasis added).

The court went on to hold that trustees may only avoid transfers to a "transferee," and that the bank was not such a transferee because it never acquired a beneficial interest in the funds. *See id.* (citing *In re Chase & Sanborn Corp.*, 848 F.2d 1196, 1200 (11th Cir. 1988)). It concluded that "the shareholders were the only 'transferees' of the funds [and that] section 546(e) offers no protection from the trustee's avoiding powers to shareholders; rather, section 546(e) protects only commodity brokers, forward contract merchants, stockbrokers, financial institutions, and securities clearing agencies." *Id.* The court therefore held section 546(e) inapplicable because the transaction did not involve a transfer to "one of the listed protected entities." *Id.*

We, however, are more persuaded by the dissent which relied, as we do, on the plain language of the statute. *See id.* at 613 (Hatchett, C.J., concurring in part and dissenting in part). Section 546(e) protects from trustee's avoidance powers settlement payments made "by . . . a financial institution." The majority in *Munford* seems to have read into section 546(e) the requirement that the "commodity brokers, forward contract merchants, stockbrokers, financial institutions, and securities clearing agencies" obtain a "beneficial interest" in the funds they handle for the section to be applicable. This requirement is not explicit in section 546.[11]

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[11] Nor does it logically follow from the application of section 550, which allows trustees to recover property that was the subject of an avoided transfer from the transferee, *see* 11

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Despite the fact that payments to shareholders in an LBO are not the most common securities transaction, we see no absurd result from the application of the statute's plain language and will not disregard it. We hold, therefore, that section 546 applies to the transaction and prevents its avoidance under section 548(a)(1)(B).[12]

[Footnote continued from previous page]

U.S.C. § 550, as the *Munford* majority seemed to indicate. *See Munford,* 98 F.3d at 610.

12 Lowenschuss contends that the Pension Plan was improperly added as a party and that the Bankruptcy Court lacked jurisdiction because the removal to the Bankruptcy Court from the District Court for the Eastern District of Pennsylvania was invalid. We decline to discuss these claims, noting instead that they are without merit.

IV.

We conclude that Resorts does not deserve restitution under the state law claims; that Resorts may not avoid the transfer of funds to Lowenschuss by way of the bankruptcy statute; and that jurisdiction was proper in the Bankruptcy Court. We will affirm.

A True Copy:

Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

APPENDIX B

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

NOT FOR PUBLICATION

March 26, 1998

LETTER OPINION
ORIGINAL ON FILE WITH CLERK OF THE COURT

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Re: In Re: Resorts International, Inc.,
Resorts International Financing, Inc.,
Griffin Resorts, Inc., and Griffin
Resorts Holding, Inc.

Fred Lowenschuss, individually and as Trustee
of Fred Lowenschuss, I.R.A., Laurance
Lowenschuss, I.R.A., and Fred Lowenschuss
Associates Pension Plan
v. Resorts International, Inc.
Civil Action No. 97-4710 (NHP)

Dear Counsel:

This matter comes before the Court on the appeal of Fred Lowenschuss from an April 22, 1997 restitution Order of the United States Bankruptcy Court for the District of New Jersey, which directed him to remit $3,805,200.00 to appellee Resorts International, Inc. ("Resorts"). The Court heard oral argument in this matter on December 22, 1997. For the reasons explained more fully below, the Order of the bankruptcy judge is **REVERSED** and the case **REMANDED** to the Bankruptcy Court for disposition consistent with this Opinion.

FACTUAL AND PROCEDURAL BACKGROUND

In 1988, Griffco Acquisition Corporation purchased Resorts in a leveraged buyout for $36.00 per share. Resorts sent a Proxy Statement dated August 4, 1988 to all shareholders, explaining the terms of the merger agreement, including the right of recordholders to receive $36.00 per share or to seek appraisal rights in the Delaware courts.

Prior to the Griffco acquisition, Donald Trump, in late 1987, made a tender offer to purchase Resorts Class A shares at $15.00 per share. This proposal was rejected by a special

committee of Resorts as grossly inadequate. Beginning in November, 1987, several shareholder derivative and class action lawsuits were filed in Delaware Chancery Court. These suits were then consolidated and eventually settled in March, 1988, when Trump agreed to increase his tender offer to $22.00 per share.

The day before the hearing on the proposed settlement, Merv Griffin made an offer to purchase all publicly held Class A shares for $35.00 per share. Thereafter, two class action suits were commenced in the United States District Court for the District of New Jersey, and another was commenced in the Delaware state courts, which raised objections to the proposed merger. Griffin subsequently raised his offer to $36.00 per share of Class A Resorts stock.

After certifying a class and notifying all class members, the Delaware court held a hearing at which Lowenschuss raised several objections to the proposed settlement. At the time, Lowenschuss held, either individually or in his representative capacity, 105,900 shares of Resorts Class A stock. The Delaware court rejected Lowenschuss' objections, and entered an order and final judgment on September 28, 1988, which dismissed the action with prejudice as to all defendants. Lowenschuss appealed this decision to the Delaware Supreme Court on the grounds that he should have been allowed to opt out of the class and proceed with an appraisal action.

The Delaware Chancery Court ultimately approved the merger, which was consummated on November 15, 1988. Shortly thereafter, Resorts sent to all shareholders a "Notice of Merger of Griffco Acquisition Corp With and Into Resorts International Inc.," together with a Letter of Transmittal, which explained to shareholders their right either to tender their shares for the merger price or to seek appraisal. Lowenschuss sent a letter to Resorts demanding appraisal rights on behalf of the Fred Lowenschuss Associates Pension Plan, the Fred Lowenschuss I.R.A., and the Laurance Lowenschuss I.R.A.

Under Section 262 of the Delaware Corporation Law, a shareholder may withdraw a demand for appraisal within the sixty days following the effective date of the merger or, thereafter, a shareholder may withdraw a demand for appraisal only with written approval from the corporation. Lowenschuss did not withdraw his demand for appraisal within the sixty-day statutory period, but rather, on February 10, 1989, he brought a separate appraisal action in the United States District Court for the Eastern District of Pennsylvania. The district judge dismissed the action without prejudice because of the pending proceedings in the Delaware Chancery Court. See Lowenschuss v. Resorts Int'l, Inc., No. 89-1071 (E.D. Pa. 1989), attached as Exhibit 13 to Appellant's Designation of Contents for Inclusion in Record and Statement of Issues on Appeal of May 20, 1997 Judgment and Amended Judgment, Volume I ("Volume I"); In re Resorts International, Inc., Adv. No. 90-1005, slip op. at 4-7 (Bankr. D.N.J. April 22, 1997) ("Bankr. Op.").

On February 17, 1989, Resorts filed a Petition for Appraisal in Delaware Chancery Court. Bankr. Op. at 7. In an accompanying affidavit, Resorts identified Lowenschuss as a party seeking appraisal. On May 31, 1989, the Delaware Chancery Court issued a "Notice of Entitlement to Appraisal," which explained, inter alia, that shareholders seeking appraisal must "deliver [their] stock certificate or certificates to the Register in Chancery within sixty (60) days of this notice [or risk] dismissal of the appraisal proceedings as to [the] shares." Exhibit 12 to Volume I. Lowenschuss never delivered his certificates.

On June 21, 1989, Lowenschuss filed an amended complaint in the Eastern District of Pennsylvania against Resorts and several other defendants, which again requested appraisal of 105,900 shares of Resorts stock. On June 29, 1989, the district judge again dismissed without prejudice Lowenschuss' appraisal proceeding in favor of Resorts' pending appraisal proceeding in the Delaware Chancery Court.

Apparently, Lowenschuss later determined that his appraisal rights would be less favorable than the merger price of $36.00 per share. To that end, on July 13, 1989, Lowenschuss filed in the Eastern District of Pennsylvania a "Petition Requiring Resorts . . . to Pay $36.00 Merger Price to Plaintiffs Immediately for 105,900 Shares of Resorts Class A Stock Owned by Plaintiffs and Which Are Hereby Being Tendered and to Complete the Record." See Exhibit 16 to Volume I. On the following Monday, July 17, 1989 — prior to the end of the sixty-day period under the Delaware Chancery Court's May 31, 1989 Order — Lowenschuss tendered his shares to Merrill Lynch Pierce Fenner & Smith, Inc. ("Merrill Lynch") in Philadelphia, Pennsylvania.

Sometime on or between July 18, and July 26, 1989, Chase Manhattan Bank ("Chase"), Resorts' transfer agent, received the shares tendered by Lowenschuss. On August 1, 1989, Resorts' treasurer authorized Morgan Guaranty Bank to transfer $3,812,313.60 to Resorts. See Bankr. Op. at 33. On or about August 3, 1989, Chase delivered a check to Merrill Lynch for $3,805,200.00, which was paid over to and received by Lowenschuss. Bankr. Op. at 13.

Resorts later brought an adversarial proceeding in the Bankruptcy Court, seeking full restitution of the transferred amount on the grounds that the payment was the result of a mistake by a Resorts employee, was a product of fraud, and was contrary to Delaware statutory law. After a two-day trial, the Bankruptcy Judge awarded Resorts full restitution of the transferred amount on the alternative grounds of mistake of fact and fraud.

DISCUSSION

I. Standard of Review

This Court will not disturb the Bankruptcy Court's factual findings unless they are clearly erroneous. See Fed. R. Bankr. P.

8013. A finding is clearly erroneous when, although there is evidence to support it, the court reviewing the entire record is left with the definite and firm conviction that a mistake has been committed. See United States v. U.S. Gypsum Co., 333 U.S. 364, 395 (1948). This Court exercises plenary review with respect to questions of law. See In re Indian Palms Assocs., Ltd., 61 F.3d 197, 203 (3d Cir. 1995).

A. Mistake

Resorts argued before the Bankruptcy Court that it was entitled to relief on the grounds of both mistake of fact and mistake of law. According to Resorts, the person responsible for transferring funds to tendering shareholders was unaware that Lowenschuss was a party to an appraisal action. Therefore, Resorts contended, Resorts paid Lowenschuss the merger price as the result of a mistake of fact. Alternatively, Resorts argued that the "employee responsible for transferring the money to the exchange agent was under the mistaken belief that Resorts was obligated to pay for all shares tendered, regardless of whether the holder had preserved his or her appraisal rights," and that the payment to Lowenschuss therefore resulted from a mistake of law. Bankr. Op. at 27.

The Bankruptcy Court found that Resorts' payment had resulted from a mistake of fact. See Bankr. Op. at 28. The court also found that Lowenschuss had committed both legal and equitable fraud. See id. at 43-50. Either of these findings can justify a restitution award. See Continental Trailways, Inc. v. Director, Division of Motor Vehicles, 102 N.J. 526, 548 (1986) (stating the "general common-law rule that where a party, without mistake of fact, fraud, duress, or extortion, voluntarily pays money on a demand that is not enforceable against him, he may not recover it").

Turning to the present appeal, the bankruptcy judge correctly observed that Resorts is "charged with the duty of

knowing the status of its shareholders, and does not dispute that it knew that Lowenschuss was seeking appraisal" when it authorized payment for the shares. Bankr. Op. at 32-33 (citing Alabama By-Products v. Cede & Co., 657 A.2d 254, 262 (Del. 1995)). This finding should have precluded Resorts' claim of mistake of fact. The bankruptcy judge concluded, however, that:

> Resorts made a mistake of fact. Resorts' employees including its former Treasurer, Thomas O'Donnell, and its Chief Financial Officer, Matthew B. Kearney mistakenly believed that Resorts was obligated to pay $36.00 for all Resorts shares tendered.

Bankr. Op. at 28.

If Resorts misunderstood its payment obligations viz. tendered shares, then Resorts was mistaken about the relevant law — not facts. The bankruptcy judge's finding of a mistake of fact was incorrect as a matter of law, and Resorts appears to concede this point on appeal. See Brief of Appellee Resorts International, Inc. at 32 (arguing that "the Bankruptcy Court correctly ordered rescission based upon a mistake of law").[1] This case does not involve a mistake of fact. If anything, there was a mistake of law. The existence of a mistake of law is immaterial here, however, because only a showing of mistake of fact, fraud, duress, or extortion will justify restitution. See Continental Trailways, Inc., 102 N.J. at 548. Since this Court reverses the Bankruptcy Court's

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[1] Resorts' statement is not wholly accurate, however, because the Bankruptcy Court issued an order of restitution, not rescission. See Bankr. Op. at 32-34 (holding that "rescission is not appropriate because Resorts failed to exercise reasonable care to prevent the mistaken payment").

finding of a mistake of fact, and since neither duress nor extortion have been alleged, Resorts must prove fraud in order to prevail.

B. Fraud

The bankruptcy judge applied the correct legal standard for allegations of fraud. Legal fraud requires a showing that: (1) the defendant made a material misrepresentation of a presently existing or past fact; (2) which the defendant knew or believed to be false; (3) upon which the defendant intended the plaintiff to rely; (4) upon which the plaintiff did reasonably rely; and (5) which thereby damaged plaintiff. See Genari v. Weichert, 288 N.J. Super. 504, 535 (App. Div. 1996). Equitable fraud may be established by proving all of the elements of legal fraud except scienter. See Jewish Ctr. of Sussex County v. Whale, 86 N.J. 619, 625 (1981). The party alleging legal or equitable fraud must prove each element by clear and convincing evidence. See Stochastic Decisions, Inc. v. DiDomenico, 236 N.J. Super. 388, 395 (App. Div. 1989), certif. denied, 121 N.J. 607 (1990).

1. Material Misrepresentation of Fact

The bankruptcy judge determined that Lowenschuss committed three material misrepresentations of fact. First, the judge found that, by tendering his shares for payment of the merger price, Lowenschuss misrepresented to Resorts that he was legally permitted to tender them. See Bankr. Op. at 46.

This conclusion is incorrect as a matter of law. The legality of Lowenschuss' tender is, by definition, a question of law. That is, the question of whether Lowenschuss was legally permitted to tender his shares to Resorts depends upon whether he had perfected his appraisal rights under Delaware law. In turn, a

determination of whether Lowenschuss had perfected his rights depends on whether surrender of the shares to the court is a prerequisite to perfection.[2] Therefore, assuming that Lowenschuss' tender constituted a representation that his tender was authorized, it was a representation of law — not fact. Indeed, this is the only conclusion consistent with the Bankruptcy Court's detailed legal analysis, which explained:

> [U] nder Delaware law, an undisputed owner of shares may perfect his appraisal rights without surrendering the shares to be marked "Not Negotiable." In Alabama By-Products v. Cede & Co., 657 A.2d 254, 258 (Del. 1995), the Supreme Court of Delaware affirmed the Vice Chancellor's finding that an appraisal shareholder's failure to surrender the stock certificates does not prevent the uncontested owner of the shares from perfecting his appraisal rights. The Vice Chancellor stated that the purpose of surrendering stock certificates is to prove actual ownership of stock by each claimant. Where ownership of the stock is not contested, surrender of the stock certificates is not required in order to perfect appraisal rights. Id. Accordingly, this Court finds that [Lowenschuss] had perfected his appraisal rights . . . at the time of tendering his shares.

Bankr. Op. at 40-41. Clearly, if Lowenschuss misrepresented to Resorts that his tender was permissible, he misrepresented only subtleties of Delaware law. These representations do not concern

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[2] It is uncontested that Lowenschuss did not surrender his shares to the Delaware Court. See Bankr. Op. at 40.

a "presently existing or past fact," and the Bankruptcy Court's contrary conclusion was erroneous.

In addition, this Court has serious doubts about whether Lowenschuss' tender amounted to a representation at all. It is clear from the record that, in tendering his shares for the merger price, Lowenschuss was guided by the Letter of Transmittal that Resorts had mailed to its shareholders.[3] That letter instructed, in pertinent part:

> If a demand for appraisal has been filed with respect to the Shares formerly represented by the Certificate(s), the undersigned hereby withdraws such demand and agrees that the value of such Shares is not more than the per Share value of the Merger Consideration and Resorts hereby accepts such withdrawal.

Letter of Transmittal, attached as Exhibit 5 to Volume I (emphasis added).

The quoted language clearly and unambiguously informs appraisal shareholders that they may, by signing the Letter of Transmittal, withdraw their demands for appraisal. Moreover, Resorts' reference to "Shares formerly represented by the Certificate(s)" clearly suggested that shareholders who had already surrendered their shares to an appraising court and perfected their rights could nonetheless withdraw those appraisal demands and tender the shares to Resorts. The Letter also clearly indicates that Resorts would accept such withdrawal. In tendering his shares,

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[3] The Bankruptcy Court found that, regardless of what the Letter of Transmittal instructed, Lowenschuss should have known that his tender violated Delaware law. As explained further below, however, this imputation of knowledge was improper.

Lowenschuss was merely following the instructions authored by Resorts. To the extent that those instructions were legally inaccurate or misleading, those inaccuracies and misrepresentations were generated by Resorts, not Lowenschuss.

The second misrepresentation identified by the lower court was comprised of the pleadings Lowenschuss submitted in support of his appraisal action in the Eastern District of Pennsylvania. Since this misrepresentation consisted solely of the language within the four corners of Lowenschuss' pleadings, this Court reviews the bankruptcy judge's interpretation de novo. As the Third Circuit has instructed, where "the issue is what legal significance derives from the wording of the pleadings . . . [w]e have held that interpretation of a writing is generally a question of law for the court." Ingersoll-Rand Financial Corp. v. Anderson, 921 F.2d 497, 499 (3d Cir. 1990) (holding that construing the language of pleadings "does not involve an issue such as historical fact or credibility of witnesses on which [appellate courts] defer") (citations omitted).

In this case, the bankruptcy judge found:

> In his Petition dated July 13, 1989, Lowenschuss stated that he was "hereby tendering" all of his shares for "immediate payment of the merger price of Thirty-six Dollars ($36.00) per share plus the interest which plaintiffs may be entitled to." [Exhibit 16 to Volume I.] By requesting a court order and a payment of interest (which only a court could order), the Trustee not only led Resorts and the Pennsylvania court to believe that he was placing his shares in the custody of the court, but he acknowledged his understanding that he could not receive the merger price without the express approval of a court. [Bankr. Op. at 47 (emphasis added)] This court finds that the language of the Petition can only be interpreted as

> informing the Court that Lowenschuss was seeking a court-ordered, judicial remedy, not as simply a notice pleading informing the court and Resorts that he has already tendered the shares. The Trustee's overly-technical reading of the language of the motion papers cannot be credited. [Bankr. Op. at 42.]

The judge's conclusion that Lowenschuss' pleadings misrepresented that he was surrendering his shares to the district court was thus based upon two considerations: the language of Lowenschuss' pleadings and the fact that he sought a judicial remedy.

While the judge's finding that Lowenschuss was seeking a judicial remedy is obviously correct, that fact does not support an inference that Lowenschuss represented an intention to surrender his shares to the court. Moreover, Lowenschuss' decision to seek a court order compelling Resorts to pay for his shares did not preclude him from pursuing other avenues of relief, such as privately asking Resorts to pay voluntarily — which Resorts in fact did. The reason Lowenschuss sought a court order, apparently, was that no one, including Lowenschuss, anticipated that Resorts would voluntarily pay him for the tendered shares. Whatever Lowenschuss' motives, however, the mere fact that he filed a lawsuit is legally insufficient, on the present facts, to establish a material misrepresentation by clear and convincing evidence.

With regard to the language of Lowenschuss' pleadings, this Court finds nothing stated therein that manifests an intention to place the shares in the court's custody. To the contrary, Lowenschuss' Reply Memorandum stated that "Plaintiffs[,] rather than post their stock, have tendered same for payment." Plaintiff's Reply Memorandum, attached as Exhibit 19 to Volume I. In this Court's view, the quoted language indicates that Lowenschuss had

tendered his shares to Resorts — not to the federal court in Pennsylvania.[4]

The Bankruptcy Court rejected this interpretation as an "overly-technical reading of the language of the motion papers [that] cannot be credited." Bankr. Op. at 42. Specifically, the bankruptcy judge stated that:

> [T]his Court [does not] find credible Lowenschuss' assertion that the accompanying memorandum of law filed with the Petition which requested that the District Court require Resorts to immediately accept and pay for the stock made clear that Lowenschuss was tendering the shares to Resorts. . . . [Lowenschuss'] overly-technical reading of the motion papers cannot be credited.

Bankr. Op. at 41-42.

As an initial matter, this Court must note that Lowenschuss' credibility is not at issue here. The parties do not dispute the underlying facts concerning Lowenschuss' conduct, but rather dispute the legal effect of that conduct — i.e., whether Lowenschuss' pleadings misrepresented material facts to Resorts. This Court finds nothing in the Pennsylvania pleadings that states or otherwise implies that Lowenschuss was surrendering his shares to the court. Nevertheless, the Bankruptcy Court reasoned that the language in the pleadings, combined with the fact that

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[4] Moreover, even if Lowenschuss had expressly certified that his shares were in the court's custody, Resorts' Letter of Transmittal invited shareholders to tender their shares regardless of whether they had surrendered their certificates to an appraising court. See Letter of Transmittal, attached as Exhibit 5 to Volume I.

Lowenschuss sought a court order, amounted to a representation that Lowenschuss had surrendered his shares to the court and that he would await judicial relief. See Bankr. Op. at 42. If this inference is plausible, it is nonetheless strained, and more to the point, it is a long way from the clear and convincing evidence required to establish an element of fraud.

In sum, this Court finds nothing in the papers Lowenschuss filed in the Eastern District of Pennsylvania that implied he was placing his shares in the court's custody. Nor does the fact that he sought a court order create such an implication. Under the clear and convincing evidence standard applicable to claims of fraud, the lower court's conclusion that Lowenschuss' pleadings constituted a material misrepresentation fact was erroneous.

Finally, the Bankruptcy Court ruled that Lowenschuss' failure to notify either the district court or Resorts that he had tendered his shares to Merrill Lynch amounted to a material misrepresentation. Specifically, the judge found that:

> [Lowenschuss'] assertion that the Petition and Request for Reconsideration filed in the District Court were effective to put Resorts and the District Court on notice of [Lowenschuss'] previous tender of the shares is not credible.

Bankr. Op. at 41.

First, this Court must emphasize that Lowenschuss' credibility is immaterial to the question of whether Lowenschuss' actions, which are not in dispute, provided Resorts with adequate notice of the tender. The record clearly reveals that Resorts received adequate notice: Merrill Lynch delivered the tendered shares to Resorts' transfer agent, Chase Manhattan Bank, sometime between July 18 and July 26, 1989. See Bankr. Op. at 11. Moreover, the Bankruptcy Court specifically found, as a factual matter, that "Chase identified the [Lowenschuss] Pension Plan and

I.R.A. as tendering shareholders in a transfer journal sheet dated July 26, 1989, some five days before the date Resorts authorized payment for the shares." Bankr. Op. at 33. Resorts therefore had sufficient notice of the tender when it authorized payment on August 1, 1989.

With regard to Lowenschuss' failure to notify the district court of his tender, this Court does not believe that the present facts gave rise to such an obligation. But even assuming that Lowenschuss had a duty to notify the district court of his tender, and even assuming that he breached that duty, such a showing would not discharge Resorts' burden to prove, by clear and convincing evidence, that Lowenschuss misrepresented a material fact to Resorts. Misrepresentations made to third parties, even a federal court, add nothing to Resorts' claim of fraud.

For the reasons explained above, this Court concludes that the record cannot support a finding that Lowenschuss misrepresented a material fact to Resorts.

2. Knowledge of Falsity

The lower court found that Lowenschuss "knowingly misrepresented to Resorts that he was entitled to tender his shares for payment[; that he] tendered the shares knowing that they were subject to an appraisal proceeding; and that [he] knowingly concealed from the district court the fact of his tender." Bankr. Op. at 46. The court determined that Lowenschuss made these representations knowingly because:

> Fred Lowenschuss testified that he read the proxy statement which set forth the limitations on his ability to withdraw his appraisal rights and which attached the full-text of Section 262 of the Delaware Code. . . . [A]t the time of the transaction, Fred Lowenschuss was a sophisticated business person. . . . Fred Lowenschuss was at the

> time of trial a lawyer for approximately 39 years, and he had experience litigating shareholders' rights actions under Delaware law.... Fred Lowenschuss was also a successful investor for the Pension Plan and IRAs.

Bankr. Op. at 46.

Assuming, arguendo, that Lowenschuss made material misrepresentations, the lower court misapplied the law when it concluded that he made those misrepresentations knowingly. The bankruptcy judge did not make any specific findings regarding Lowenschuss' knowledge, but rather imputed the requisite knowledge to Lowenschuss on the basis of his experience and sophistication. That is, the judge did not find that Lowenschuss actually knew that his tender was contrary to law, or that he willfully closed his eyes to the truth. Instead, the judge ruled that a person of Lowenschuss' experience and sophistication should have known that the tender was unauthorized:

> [T]his Court finds that [Lowenschuss] had perfected his appraisal rights, and that [he] had reasonable grounds to believe at the time of tendering his shares, that he had perfected his appraisal rights.

Bankr. Op. at 41 (emphasis added). Such an imputation of knowledge was improper. The record cannot support holding Lowenschuss to a higher standard of care than Resorts, who was equally sophisticated, who drafted the Letter of Transmittal inviting shareholders to withdraw their demands for appraisal and receive the merger price simply by signing the Letter, and who was under a statutory duty to know the status of its shareholders.

In sum, this Court concludes that the record cannot support a finding, by clear and convincing evidence, that Lowenschuss knowingly misrepresented facts to Resorts, because there was no

evidence that Lowenschuss actually knew or believed that his tender was unlawful.[5]

3. Reasonable Reliance

As an initial matter, it is not at all clear that Resorts in fact relied, reasonably or otherwise, upon any of Lowenschuss' alleged misrepresentations. The Bankruptcy Court found that "Resorts authorized payment for the shares . . . in reliance upon Lowenschuss' misrepresentations." Bankr. Op. at 48. However, the court cited no evidence of Resorts' reliance other than the testimony of Christopher Whitney, Resorts' former general counsel, who stated that "he understood at the time of

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[5] It is worth repeating, however, that even if Lowenschuss' tender amounted to a representation that his tender was authorized under Delaware law, and even if he subjectively believed that representation to be false, it was not a representation of fact, and thus could not serve as a predicate for fraud. See page 9, supra. Similarly, the question of whether Lowenschuss' shares were, at the time of tender, subject to a perfected appraisal proceeding is a question of law. See Bankr. Op. at 40-41 (discussing when, under Delaware law, perfection of appraisal rights requires surrender of the certificates to the appraising court).

To the extent that the Bankruptcy Court construed Lowenschuss' Pennsylvania pleadings as a misrepresentation that he had surrendered his shares to the court, Lowenschuss made those representations knowing that they were false. However, as explained at pages 11 through 13, supra, nothing in Lowenschuss' pleadings amounted to a material misrepresentation of fact.

Lowenschuss' tender of the shares that Lowenschuss had declined the merger price and was proceeding with the matter in the courts and further that it never occurred to him, Whitney, that anyone would invoke appraisal rights and also seek to be paid the merger price." Bankr. Op. at 48-49.

Whitney's testimony does not establish actual reliance. It merely established that he assumed, mistakenly, that an appraisal shareholder would never attempt to tender his or her shares. The import of Whitney's assumption is also substantially undercut by the Letter of Transmittal, which clearly invited appraisal shareholders to tender their shares. Moreover, his testimony is wholly unrelated to any of Lowenschuss' alleged misrepresentations.

Resorts' claim of reliance is further undercut by the Bankruptcy Court's finding that Resorts, even after learning of the mistaken payment to Lowenschuss, failed to establish any procedures to prevent such improper payments. See Bankr. Op. at 33-34. Indeed, the Bankruptcy Court found that Resorts continued to accept and pay for shares tendered by other appraisal shareholders. See id. In short, the record does not support a finding of actual reliance.

Even assuming, arguendo, that Resorts relied upon any of the misrepresentations identified by the Bankruptcy Court, that court's well-supported finding that Resorts breached its duty to exercise reasonable care must preclude a finding of reasonableness. Indeed, the bankruptcy judge refused to rescind the transaction because:

> Resorts failed to exercise reasonable care when it authorized payment to Lowenschuss when he surrendered his shares. Resorts breached its duty to adequately supervise the surrender of shares for the merger consideration by failing to make even a cursory investigation as to the identity of the tendering shareholder and whether that

> shareholder had previously sought appraisal rights.
>
> The record further demonstrates that Chase identified the Pension Plan and I.R.A. as tendering shareholders in a transfer journal sheet dated July 26, 1989, some five days before the date Resorts authorized payment for the shares. Resorts failed to provide a list of appraisal shareholders to the employees responsible for payment upon surrender of the shares, nor did Resorts provide such a list to Chase. Even after learning of the illegal payment to Lowenschuss, Resorts failed to issue corrected instructions to Chase to cease all payments to appraisal shareholders who failed to obtain the requisite approvals pursuant to Section 262. The record demonstrates that Resorts paid other appraisal shareholders, even after Resorts' counsel notified Lowenschuss of [Resorts'] intention to recover the funds paid to Lowenschuss.
>
> Accordingly, this court finds that, even if the payment was the result of mistake, rescission is not appropriate because Resorts failed to exercise reasonable care to prevent the mistaken payment.

Bankr. Op. at 33-34 (emphasis added).[6]

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[6] Although not challenged on appeal, this Court notes that the bankruptcy judge properly denied Resorts' request for rescission.

The Bankruptcy Court did not explain its finding of reasonable reliance, other than to state that "Resorts' reliance was both reasonable and justifiable given [Lowenschuss'] numerous misrepresentations to Resorts and to the Pennsylvania District Court." Bankr. Op. at 49. This is particularly problematic in light of that court 's earlier finding that Resorts failed to exercise reasonable care when it failed to take any steps to prevent such payments. The Bankruptcy Court also failed to explain how Resorts' practice of paying for all shares tendered — regardless of whether those shares were subject to an appraisal proceeding — could be consistent with a claim of reasonable reliance.

Given the lower court's well-supported conclusion that "Resorts failed to exercise reasonable care to prevent the mistaken payment," Resorts' reliance upon Lowenschuss' alleged misrepresentations was clearly unreasonable. Bankr. Op. at 34. The lower court's finding to the contrary is unsupported in either fact or law.

After reviewing the entire record, this Court holds that the relevant facts and law cannot support the Bankruptcy Court's restitution order. As discussed above, this case does not involve a mistake of fact; nor can the record support a finding that Resorts reasonably relied upon a material misrepresentation of fact. Lowenschuss committed neither legal nor equitable fraud, and, therefore, the Bankruptcy Court's order of restitution cannot stand.[7] In light of the foregoing, this Court must also vacate the Bankruptcy Court's punitive damages award.

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[7] Although it is unclear from the record, it appears that the Bankruptcy Court also held, as an alternative ground for the restitution award, that "the parties did not act in pari delicto." Bankr. Op. at 38-40 (citing 2 George E. Palmer, The Law of Restitution § 8.6, 203 (1978)). While this Court expresses no opinion about whether New Jersey courts have adopted this

[Footnote continued on next page]

CONCLUSION

For the reasons explained above, the judgment of the Bankruptcy Court is **REVERSED**, and the case **REMANDED** to the Bankruptcy Court for disposition consistent with this Letter Opinion.

/s/
NICHOLAS H. POLITAN
U.S.D.J.

[Footnote continued from previous page]

doctrine, it is wholly inapplicable to the facts of this case because there is no evidence in the record that suggests that Lowenschuss was more responsible than Resorts for the mistaken payment.

This Court has also considered Resorts' contention that the transaction is avoidable as a fraudulent conveyance. The bankruptcy judge properly rejected this argument because the debtor, Resorts, did not transfer the funds with the requisite intent to hinder, delay, or defraud creditors. See 11 U.S.C. § 548(a)(1); Bankr. Op. at 51-58.

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

RESORTS INTERNATIONAL, INC., RESORTS INTERNATIONAL FINANCING, INC., GRIFFIN RESORTS, INC., and GRIFFIN RESORTS HOLDING, INC.,	:	CIVIL ACTION NO. 97-4710
	:	HON. NICHOLAS H. POLITAN
Debtors.	:	ORDER
FRED LOWENSCHUSS, individually and as Trustee of FRED LOWENSCHUSS, I.R.A., LAURANCE LOWENSCHUSS, I.R.A., and FRED LOWENSCHUSS ASSOCIATES PENSION PLAN,	:	
Plaintiffs,	:	
v.	:	
RESORTS INTERNATIONAL, INC.,	:	
Defendant.	:	

THIS MATTER having come before the Court on Lowenschuss' appeal from an Order of the Honorable Rosemary Gambardella, United States Bankruptcy Court, dated April 22, 1997, and oral argument having been heard on December 22, 1997, and the Court having considered the matter as well as the submissions of the parties, and for the reasons appearing more

particularly in the Letter Opinion of the Court in the above-captioned matter, and good cause having been shown,

IT IS on this 26th day of March, 1998,

ORDERED that the Order of the Bankruptcy Court, dated April 22, 1997, is hereby **REVERSED**, and it is further

ORDERED that the matter is hereby **REMANDED** to the Bankruptcy Court for further proceedings consistent with this Opinion.

/s/
NICHOLAS H. POLITAN
U.S.D.J.

APPENDIX C

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

IN RE:	
RESORTS INTERNATIONAL, INC., RESORTS INTERNATIONAL FINANCING, INC., GRIFFIN RESORTS INC., AND GRIFFIN RESORTS HOLDING, INC., Debtors.	CHAPTER 11 CASE NOS. 89-10119 89-10120 89-10461 89-10462
RESORTS INTERNATIONAL, INC., Plaintiff, v. FRED LOWENSCHUSS, individually and as Trustee of FRED LOWENSCHUSS, I.R.A., and LAURANCE LOWENSCHUSS, I.R.A., and FRED LOWENSCHUSS ASSOCIATES PENSION PLAN, Defendants.	ADV. NO. 90-1005 OPINION

APPEARANCES:

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Attorney(s) for Defendant, Laurance Lowenschuss, Current Trustee of Fred Lowenschuss Associates Pension Plan and Laurance Lowenschuss, IRA

Rosemary Gambardella, Bankruptcy Judge

The subject of the instant adversary action is a July 1989 transaction between Resorts International Inc. ("Resorts") and Fred Lowenschuss, individually and in his representative capacities (the Defendants). The present Amended Complaint of Resorts[1] seeks to rescind the payment of $3,805,200.00, paid in July 1989, to the Trustee after it is alleged he fraudulently tendered an estimated 105,700 shares of Class A common stock of Resorts.

By order dated September 19, 1995, this Court severed the claims against Fred Lowenschuss individually and as Trustee of the Fred Lowenschuss I.R.A. and as former Trustee of the Fred Lowenschuss Associates Pension Plan and as former trustee of the Laurance Lowenschuss IRA and the other action against the current trustee of the Fred Lowenschuss Associates Pension Plan and the current trustee of the Laurance Lowenschuss IRA.

On November 2, 1995 and November 3, 1995, trial was conducted on Resorts' claims against Laurance Lowenschuss as successor and current Trustee of the Fred Lowenschuss Associates Pension Plan and successor and current trustee of the Laurance Lowenschuss IRA. The following constitutes this Court's findings of fact and conclusions of law.[2]

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[1] Sun International North America, Inc. is the successor in interest to Griffin Gaming and Entertainment, Inc., which was formerly known as Resorts International Inc. The Debtor/Plaintiff herein shall be referred to as "Resorts".

[2] On August 24, 1992, Fred Lowenschuss filed a Chapter 11 petition in the United States Bankruptcy Court for the District of Nevada. By order dated February 26, 1997, the Nevada Bankruptcy Court, by order of Bankruptcy Judge Gregg W. Zive, modified the automatic stay of § 362 to allow this Court to issue its decision in this Adversary Proceeding.

FACTS

The Merger

In 1988, Griffco Acquisition Corp. ("Griffco") purchased Resorts in a leveraged buyout for $36.00 per share. Resorts sent a Proxy Statement dated August 4, 1988 to all shareholders, detailing the terms of the merger agreement, including the right of recordholders of Resorts stock to receive $36.00 per share or to seek appraisal rights under Delaware General Corporation Law § 262 ("Section 262"). The Proxy Statement included the full text of Section 262 as an appendix (Annex III). Exh. 3 at 44-46.

The origin of the instant adversary action can be traced back to a 1988 leveraged buyout of Resorts by Merv Griffin. In late 1987 Donald J. Trump made a tender offer to purchase Resorts Class A shares at $15 per share. This proposal was rejected by a special committee of Resorts as grossly inadequate. Beginning in November, 1987, several shareholder derivative and class action suits were filed in Delaware Chancery Court. These suits were eventually consolidated and ultimately settled in March, 1988, when Donald Trump agreed to increase his tender offer to $22 per share.

The day before the hearing on the proposed settlement, Merv Griffin made an offer to purchase all publicly held Class A shares for $35 per share. Thereafter, two different class action suits were commenced in the U.S. District Court for the District of New Jersey, and another was commenced in Delaware State Court, objecting to the proposed merger and alleging fraud, mismanagement and breach of fiduciary duties. Griffin subsequently raised his offer to $36 per share of Class A Resorts stock.

After certifying a class and notifying all class members, the Delaware court held a hearing at which Lowenschuss raised a number of objections to the proposed settlement. At the time,

Lowenschuss held, either individually or in his representative capacity, 105,900 shares of Resorts Class A stock and an unspecified amount of two issues of Resorts debentures. The Delaware court rejected Lowenschuss' objections, and entered an order and final judgment approving the amended settlement and dismissing the Delaware and New Jersey actions with prejudice to all defendants on September 28, 1988. Lowenschuss thereafter appealed this decision to the Delaware Supreme Court on the grounds that he should have been allowed to opt out of the class and proceed with an appraisal action.

The Delaware Chancery Court issued an Opinion dated September 7, 1988 approving the Agreement and Plan of Merger. Exh. 5. On November 15, 1988, the merger between RII and Griffco Acquisition Corp. was consummated. On or about November 15, 1988, the Effective Date of the Merger, Resorts sent a Notice of Merger of Griffco Acquisition Corp. With and Into Resorts International Inc. ("Notice of Merger"), together with a Letter of Transmittal, to all shareholders. See Exh. 7. The Notice of Merger provided in relevant part:

> NOTICE IS HEREBY GIVEN that the merger (the "Merger") of Griffco Acquisition Corp., a Delaware corporation ("Griffco"), with and into Resorts International, Inc., a Delaware corporation ("Resorts", and referred to with respect to the period following the Merger as the "Surviving Corporation"), became effective on November 15, 1988 (the "Effective Time"). As a result of the Merger, Resorts became a wholly owned subsidiary of The Griffin Company ("Griffin"), a Connecticut corporation and sole stockholder of Griffco.
>
> Pursuant to terms of the Merger, each of the outstanding shares ("Shares") of Class A Common Stock, par value $1.00 per share, and Class B Common Stock, par value $1.00 per share, of Resorts (other than Shares beneficially owned by

Griffin and entities controlled by Griffin or by Resorts and its subsidiaries and other than Shares as to which appraisal rights have been demanded and perfected) was converted into the right to receive $36.00 in cash, without interest thereon, upon the surrender of the certificate representing such Share. At and after the Effective Time, no transfer of Shares will be made on the stock transfer books of the Surviving Corporation.

To receive payment of the $36.00 per share in cash to be paid pursuant to the Merger, record holders must complete the enclosed Letter of Transmittal (or a facsimile thereof) and must present the Letter of Transmittal and stock certificates which prior to the Merger represented Shares, to the Paying Agent on or prior to November 15, 1989. . .

* * *

Any record holder who has properly demanded appraisal of his Shares pursuant to Section 262 of the General Corporation Law of the State of Delaware may withdraw such demand and receive a $36.00 dollars per Share in cash, without interest thereon, by properly completing the Letter of Transmittal (or a facsimile thereof) and presenting it, together with the stock certificates formally representing such Shares, to the Paying Agent as indicated above. The Delivery of the Letter of Transmittal in such certificates shall be deemed to constitute a withdrawal of such demand. Stockholders who did not make a written demand for appraisal prior to the Special Meeting of stockholders held on August 26, 1988 and adjourned to August 30, 1988 may not request such appraisal. For further information regarding the procedure for appraisal, please refer to the section entitled "Appraisal Rights" and Annex III of the Proxy Statement dated August 4, 1988 which was previously delivered to stockholders in connection with the Special Meeting. . .

See Exh. 7; Exh. 7A. The Letter of Transmittal provided in relevant part:

> The undersigned hereby waives the right to demand appraisal of the value of the Shares represented by the Certificate(s) pursuant to Section 262 of the Delaware General Corporation Law. If a demand for appraisal has been filed with respect to the Shares formerly represented by the Certificate(s), the undersigned hereby withdraws such demand and agrees that the value of such Shares is not more than the per Share value of the Merger Consideration and Resorts hereby accepts such withdrawal.

Exh. 7; Exh. 7A. The Letter of Transmittal also contained a provision requiring the tendering shareholder to represent and warrant that he had

> full power and authority to surrender the Certificate(s) and that Resorts will acquire good and unencumbered title thereto, free and clear of all liens, restrictions, charges and encumbrances and the same will not be subject to any adverse claim.

Exh. 7, Letter of Transmittal, ¶ 2.

Lowenschuss Seeks Appraisal

Fred Lowenschuss ("Lowenschuss" or "the Trustee") , who held Resorts stock in several representative capacities, was among the shareholders who preserved and perfected his appraisal rights. On August 8, 1988, Lowenschuss sent a letter to Resorts demanding appraisal rights on behalf of the Fred Lowenschuss Associates Pension Plan (102,000 shares), the Fred Lowenschuss I.R.A. (100 shares), and the Laurance Lowenschuss I.R.A. (100 shares). See Exh. 4. Lowenschuss also voted against the merger,

thus satisfying the two prerequisites for perfecting his appraisal rights under Section 262.

Pursuant to Section 262, a shareholder has the option of unilaterally withdrawing a demand for appraisal for 60 days following the Effective Date of the merger and may withdraw a demand for appraisal thereafter only with written approval of the corporation. Once an appraisal proceeding is commenced, "no appraisal proceeding in the Court of Chancery shall be dismissed as to any stockholder without the approval of the Court." Del. Code Ann. tit. 8, § 262(k).

The Trustee never withdrew his demand for an appraisal during the 60-day statutory period. Instead, on February 10, 1989, Lowenschuss filed an action against Resorts and several other defendants in the United States District Court for the Eastern District of Pennsylvania, seeking inter alia, an appraisal, pursuant to Section 262, of 105,900 shares of Class A Resorts common stock. See Exh. 9.

Resorts Institutes an Appraisal Action in Delaware

On February 17, 1989, Resorts filed a Petition for Appraisal in Delaware Chancery Court. Exh. 11. An affidavit filed by Christopher D. Whitney ("Whitney"), a Senior Vice-President of Resorts and Resorts' General Counsel, listed Laurance Lowenschuss as a shareholder who had requested appraisal of 100 shares of Class A Resorts common stock and Fred Lowenschuss as a shareholder who had requested appraisal of 102,000 shares of Class A Resorts common stock on behalf of the Fred Lowenschuss Associates Pension Plan and 100 shares of Class A Resorts common stock on behalf of the Fred Lowenschuss, I.R.A. Exh. 11.

By order dated March 23, 1989 the Delaware Chancery Court directed Resorts to send a notice to all shareholders that had sought appraisal. Exh. 13. That order provided that "such notice . . . shall advise the stockholder that within 60 days of the mailing of such notice, he, she or it shall deliver to the Register in

Chancery the certificate or certificates representing the shares determined to be entitled to appraisal. Failure of a stockholder to deliver stock certificates in accordance with such notice may result in the dismissal of the proceedings as to such stockholder. Exh. 13.

On May 31, 1989 the Delaware Chancery Court issued a "Notice of Entitlement to Appraisal" pursuant to its prior order which stated that "within sixty days of the mailing of this notice you [a party seeking appraisal] are required to deliver" to the Register in Chancery "the stock certificate or certificates representing the foregoing shares". Exh. 16. The order further provided "failure to deliver your stock certificate or certificates to the Register in Chancery within sixty (60) days of this notice may result in the dismissal of the appraisal proceedings as to your shares". Exh. 16. The 60 day period ended July 30, 1989.

On June 21, 1989, Lowenschuss filed an amended complaint in the U.S. District Court for the Eastern District of Pennsylvania against Resorts and several other defendants realleging his request for appraisal of 105,900 shares of Resorts stock. Exh. 17. On June 29, 1989, the U.S. District Court for the Eastern District of Pennsylvania, Judge Thomas N. O'Neill, Jr. by Memorandum Opinion dismissed without prejudice Lowenschuss' appraisal proceeding in favor of Resorts' pending appraisal proceeding in the Delaware Chancery Court. Exh. 18. On July 6, 1989 Lowenschuss filed a motion for reconsideration of the June 29, 1989 order of dismissal. Exh. 21. The district court denied Lowenschuss' motion for reconsideration on August 3, 1989. Exh. 30.

Lowenschuss Tenders the Shares

On July 13, 1989, Lowenschuss filed in the U.S. District Court for the Eastern District of Pennsylvania a "Petition Requiring Resorts International, Inc. to Pay $36.00 Merger Price to Plaintiffs Immediately for 105,900 Shares of Resorts Class A

Stock Owned by Plaintiffs and Which Are Hereby Being Tendered and to Complete the Record" (the "Petition"), wherein Lowenschuss stated that "an appraisal action is no longer a viable or satisfactory alternative." Exh. 23, ¶ 4. In the Memorandum of Law accompanying the Petition Lowenschuss requested that the District Court "require Resorts . . . to immediately accept and pay for" the Pension Plans' and IRA's stock. Exh. 23 On July 13, 1989, Lowenschuss served the Petition on Resorts' counsel by first class mail. Exh. 23.

On Monday, July 17, 1989, prior to the end of the 60-day period under the Delaware Chancery Court's May 31, 1989 order, and prior to the district court's August 3, 1989 order denying Lowenschuss' Petition and motion for reconsideration[3] and without a request for approval to withdraw from Resorts' Delaware appraisal action, Lowenschuss tendered 105,900 shares of Class A Resorts common stock at Merrill Lynch Pierce Fenner & Smith, Inc. ("Merrill Lynch") in Philadelphia, Pennsylvania. Exhs. 24, 25.

On July 19, 1989, Resorts filed a response dated July 18, 1989 with the District Court in Pennsylvania in opposition to Lowenschuss' Petition and motion for reconsideration in response to Lowenschuss' request to the District Court to require Resorts to "accept the tender of, and pay $36 for every Resort share" Lowenschuss owned. Exh. 26. In that response Resorts took the position that Delaware General Corporate Law § 262(e) provided that a shareholder seeking approval had an unqualified right to

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[3] See Ex. 30. Lowenschuss filed a Notice of Appeal to the Third Circuit Court of Appeals on August 23, 1989, several weeks after he had tendered his shares and received $3.8 million payment therefor, challenging the trial court's refusal to order Resorts to pay $36.00 per share. (See Exh. 70). 11/3/95 Tr. at 239).

withdraw the appraisal demand and accept the terms of the merger only for a period of 60 days after the merger. Exh. 26 at p.6. Lowenschuss filed a reply memorandum to Resorts' opposition on July 19, 1989, stating in pertinent part as follows:

> 12. That under the existing circumstances plaintiffs have no intention of submitting their shares for appraisal in accordance with the "Notice of Entitlement to Appraisal" of May 31, 1989 and/or to have their certificates marked "Not Negotiable."
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> * * *
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> . . . Furthermore, there may be no funds with which to pay for the Resorts stock if payment is not ordered by the Court and received immediately. . . . Plaintiffs rather than post their stock, have tendered same for payment immediately of Thirty-six Dollars ($36.00) per share.
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> * * *
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> Justice and fairness requires that Resorts immediately pay Thirty-six Dollars ($36.00) per share for the One hundred and five Thousand Nine hundred shares (105,900) which have been properly tendered for payment by plaintiffs and that this Court permit the necessary discovery and allow the case to proceed.

Exh. 27.

Resorts Authorizes Payment to Lowenschuss

Sometime on or between July 18, 1989 and July 26, 1989, Chase Manhattan Bank ("Chase"), Resorts' transfer agent, received the shares that Lowenschuss had tendered. Exh. 8 at R 00191. On August 1, 1989 Resorts' former Treasurer, Thomas Francis O'Donnell, authorized Morgan Guaranty Bank to transfer $3,812,313.60 to Chase. Exh. 29. In his December 6, 1989

deposition,[4] Mr. O'Donnell testified that he did not actually see the shares which were tendered by Lowenschuss for payment and, consequently, did not know the identity of the shareholder who was tendering shares at the time he authorized the transfer of funds to Chase. See Combined Exhs. 42-43 at 116. O'Donnell also stated that he did not know how Chase handled the exchange of shares Combined Exhs. 42-43 at 78-79, that he did not have or transmit to Chase a list of the shareholders who had sought appraisal rights Combined Exhs. 42-43 at 58,[5] and that he did not know that Lowenschuss was not entitled on July 17, 1989 to tender his shares without permission of the Court. See Combined Exhs. 42-43 at 58, 59-60.

The record also demonstrates that Chase prepared and sent detailed stock transfer journal sheets to Resorts' administrative office in North Miami, Florida, where O'Donnell worked, listing the names of former shareholders seeking to be paid the merger price. See Exh. 28. A transfer journal sheet dated July 26, 1989 and postmarked the following day specifically identifies the Pension Plan and I.R.A. as having surrendered a total of 105,700 shares. Exh. 28.

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[4] Mr. O'Donnell was deceased in or about May 1993. The parties have jointly submitted portions of Mr. O'Donnell's December 6, 1989 deposition which were designated as combined Exhibits 42 and 43.

[5] At trial, Christopher Whitney, former General Counsel for Resorts, also testified that he did not transmit to Chase a list of shareholders who sought appraisal rights. 11/2/95 Tr. at 205.

At trial, Matthew B. Kearney ("Kearney"), Chief Financial Officer of Resorts,[6] testified that at the time Resorts authorized Morgan Guaranty to disburse funds to Chase, he believed that the merger agreement required Resorts to pay for all shares tendered, regardless of whether an appraisal action had been commenced with respect to those shares. See 11/3/95 Tr. at 22-23. Kearney testified that it was not until September of 1989, after Lowenschuss had tendered his shares and been paid, that he first developed an understanding that certain shareholders who had begun appraisal proceedings were not entitled to receive the merger price. See 11/3/95 Tr. at 49.

On or about August 3, 1989, Chase delivered a check to Merrill Lynch for $3,805,200 (Ex. 34 at R 00174), which was paid over to and received by Lowenschuss (Ex. 56 at 24, 34, 48, 60, 74).

Resorts Institutes the Present Suit Seeking Rescission and Restitution

Resorts commenced this action against Fred Lowenschuss, individually and in his representative capacities, on September 26, 1989, in the United States District Court for the Eastern District of Pennsylvania. Resorts International v. Fred Lowenschuss, et. al., Civil Action No. 89-6917. Exh. 35. Resorts seeks rescission and full restitution of the transferred amount, as well as punitive damages, on grounds that the payment was made as the result of a mistake by a Resorts employee (Count One), was a product of fraud (Count Two), and was contrary to Delaware statutory law (Count Three). The gravamen of Resorts' complaint is that a

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6 Effective June 30, 1995, Resorts was renamed Griffin Gaming and Entertainment Co., Inc.

Resorts employee mistakenly believed that Resorts was obligated to pay Defendant for his shares and that under Del. Code Ann. tit. 8, § 262, holders of shares who had preserved their appraisal rights could not be paid anything without approval of the Delaware Chancery Court.

Laurance Lowenschuss contends that the Pension Plan and Laurance Lowenschuss, I.R.A. had an absolute right to receive $36 per share at the time the shares were tendered on July 17, 1989 because, inter alia, the District Court for the Eastern District of Pennsylvania had dismissed the Pension Plan and I.R.A.'s appraisal proceeding and because he failed to properly perfect his right to appraisal by failing to surrender the shares to the Delaware Chancery Court within 60 days of the Notice of Entitlement to Appraisal issued by that court.[7] The Notice of Entitlement to Appraisal issued by the Register in Chancery of the Delaware Chancery Court is dated May 31, 1989 and the 60-day period for seeking appraisal rights "expired" on July 30, 1989. See Ex. 16. Lowenschuss tendered his shares to the cage at Merrill Lynch in

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[7] Fred Lowenschuss testified at trial that it was "[his] understanding that if [a shareholder] did not send in [his] shares to the Register in Chancery in Delaware within the 60-day period that [statute] allotted [the shareholder], that [the shareholder] can no longer be a person seeking appraisal and that [the shareholder] would be automatically dismissed from the action." 11/3/95 Tr. at 214. Lowenschuss further testified that he "concluded that based on the fact that [he] did not surrender the shares to the Register in Chancery in Delaware, as required and requested in the 60-day period, that [he] had no right to proceed in Delaware with appraisal." 11/3/95 Tr. at 230.

Philadelphia, Pennsylvania on July 17, 1989, nearly two weeks before the end of the 60-day period.

Lowenschuss also points to the September 7, 1988 opinion of Vice Chancellor Hartnett of the Delaware Chancery Court, which denied Lowenschuss' attempt to opt-out of the settlement but which also provided that: "[non-tendering shareholders] will be entitled to receive $36.00 dollars per share. . . . The opportunity afforded non-tendering shareholders to waive their appraisal rights and receive the $36.00 per share is an economic benefit resulting from the settlement." 1988 WL 92749 at *7 (Del. Ch. Sept. 7, 1988). Exh. 5.

Payments to Other Appraisal Shareholders

In addition, the Trustee alleges that payment by Resorts was not the result of mistake. At trial, Christopher Whitney, Resorts' former General Counsel, testified that he did not transmit to Chase a list of shareholders who sought appraisal rights. See 11/2/95 Tr. at 205. Even after mid-September 1989 when Whitney testified that he came to understand that Lowenschuss had tendered his shares illegally, neither Thomas O'Donnell, Resorts former Treasurer, nor Whitney instructed Chase not to pay certain shareholders who sought appraisal rights. (Tr. 11/2/95 at p. 241; Combined Exh. 42-43 at 58). Whitney testified that at the time of the tender by Lowenschuss of his shares he Whitney understood that Lowenschuss had been offered the merger price but "declined" and rather was prosecuting the action in court. Tr. 11/2/95 at 219. Whitney also testified that it never occurred to him that "anybody would invoke the appraisal rights and seek to be paid." Tr. 11/2/95 at 240. Resorts apparently paid other appraisal shareholders in the same manner as it paid Lowenschuss. Specifically, Lowenschuss points to the treatment of David Dion ("Dion"), who together with

Beverly Dion formerly owned 100 shares of Resorts Class A common stock. Like Lowenschuss, David Dion perfected his appraisal rights, instituted his own appraisal proceeding,[8] was listed as a shareholder seeking appraisal rights in Resorts' appraisal proceeding, did not receive Resorts' express written consent or court approval to withdraw that proceeding prior to tendering his shares, yet was paid $3,600 by Resorts on or about October 3, 1989, approximately three weeks after Resorts discovered that Lowenschuss had tendered his shares in a similar manner and approximately one week after Resorts had instituted the action presently before this Court.[9]

Lowenschuss' Counterclaim

Lowenschuss further responded to Resort's complaint on October 20, 1989, by filing a seven-count counterclaim against Resorts, the six directors of Resorts at the time of the merger, Donald J. Trump, Robert S. Trump, Harvey I. Freeman, George Barascillo, Jr., William Druz and Mitchell Svirdidoff, Resorts International Financing, Inc. ("RIFI") (a Resorts subsidiary) Griffco Acquisition Corp., the Griffin Company ("TGC", parent of Griffco), and two Trump entities, Trump Hotel Corporation and Trump Taj-Mahal Associates Limited Partnership. Exh. 36. The first four counts of Lowenschuss' counterclaim related to his ownership of debentures, on which he sought the immediate

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[8] On February 11, 1989, a Petition for Appraisal seeking appraisal of Resorts Class A common stock on behalf of David Dion was filed in the Delaware Chancery Court. (Exh. 10).

[9] Resorts ceased to pay $36 per share for any shareholder that tendered shares, regardless of whether appraisal had been sought, on November 3, 1989. 11/3/95 Tr. at 104.

payment of principal and interest, or, in the alternative, that any judgment awarded Resorts be set off by payments allegedly due on the debentures. The other counts alleged breach of fiduciary duty, securities fraud, violations of RICO and common law fraud. These claims were similar to those Lowenschuss brought in his appraisal action in the Eastern District of Pennsylvania, which Judge O'Neill dismissed and which Lowenschuss subsequently appealed to the Third Circuit. Exh. 17. Both Resorts and Lowenschuss requested that their claims be tried before a jury.

On October 20, 1989, Lowenschuss filed a motion for summary judgment and/or dismissal of all counts of Resorts' Complaint and for sanctions for Resorts' failure to withdraw its Complaint. Subsequently, Resorts filed motions for summary judgment on Counts One and Three.

Resorts' Bankruptcy

On November 12, 1989, involuntary petitions were filed in the Bankruptcy Court for the District of New Jersey against Resorts and Resorts International Financing Inc. ("RIFI") Exhs. 38, 39. On December 22, 1989, Resorts and Resorts International Financing Inc. ("RFI") consented to the entry of an order for relief pursuant to chapter 11 of the Code. Ext. 44. On that same date, Griffin Resorts Inc. ("GRI") and Griffin Resorts Holding Inc. ("GRH") filed separate voluntary petitions under Chapter 11 of the Bankruptcy Code. The filing of the petitions stayed all litigation against the Debtors and property of the Debtors' estate, including Lowenschuss' appeal of Judge O'Neill's decision, Resort's suit against Lowenschuss for restitution and Lowenschuss' counterclaims.

Resorts Amends the Complaint

Following Resorts' filing of its Chapter 11 petition (the "Lowenschuss Matter") was transferred to this Court from the

United States District Court for the Eastern District of Pennsylvania.[10] Resorts filed an amended Complaint dated November 1, 1990, which added three additional counts (Counts Four through Six) against the defendants alleging that the tender of shares was voidable under 11 U.S.C. §§ 544(b), 548(a) (1), 548(a) (2), 550 and N.J. Stat. Ann. § 25:2-25 and 25:2-27. On February 19, 1992 this Court issued an Opinion, memorialized by an Order dated March 4, 1992: (i) denying Defendant's motions for summary judgment on, or dismissal of, Counts One through Three of the Complaint; (ii) denying Resorts' motion for summary judgment on Count One; and (iii) granting Resorts' motion for partial summary judgment on Count Three. This Court found that the tendering of the shares transaction between Resorts and Lowenschuss was an illegal contract but declined to grant Resorts' requested remedies of rescission and restitution, holding that there existed "issues of material fact such as whether Lowenschuss acted fraudulently and whether Resorts made a mistake of fact or a mistake of law". See slip op. at 32, 36.

Resorts' Financial Condition at Time of Transfer.

Under the merger, Resorts' long-term indebtedness increased from approximately $600 million to $927 million, of which $325 million was secured debt. See 11/2/95 Tr. at 78-79; Exh. 14 at 73. In December 1988, Resorts projected its debt service for 1989 to be $133.5 million, of which approximately $120 million represented interest. Exh. 14 at 70; 11/2/95 Tr. at 82. Resorts' cash flow from operations before interest, dividends, and

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10 On June 19, 1992, an order of transfer was entered indicating that the Lowenschuss Matter was transferred from the Camden vicinage to the Newark vicinage.

taxes had ranged from $60 to $66 million in the preceding three years. Exh. 65.

In mid-May 1989, Resorts publicly announced that, during the first quarter, Resorts had lost $18,683,000. Exh. 15 at 3. Resorts stated in its May 1989 10Q filing with the Securities and Exchange Commission that "the Company anticipates serious shortfalls between its debt service and other cash needs and obligations" and that it could not "give any assurance as to the likelihood such Cash Flow will at any time be sufficient to meet the Company's debt service obligations at current levels." Exh. 15 at 6.

During the first quarter of 1989, Resorts' cash flow from operations before interest, dividends, and taxes was approximately $14.3 million. During that period, Resorts paid approximately $21.2 million in interest. Exh. 15 at 5; Exh. 66.

On August 11, 1989, Resorts filed its 10-Q for the quarterly period ending June 30, 1989. See Exh. 19. Resorts announced a net loss for the second quarter of 1989 of $27.9 million. Exh. 19 at 2. Resorts reported that it was developing a revised business plan that proposed changes in Resorts' capital structure. Exh. 19 at 8.

During the second quarter of 1989, Resorts' cash flow from operations before interest, dividends, and taxes was approximately $1.7 million. During that period, Resorts paid approximately $43.5 million in interest. Exh. 66; Exh. 19 at 5. Resorts also projected to expend $85 million making capital improvements to its Atlantic City and Paradise Island facilities. Exh. 19. at 7.

On August 23, 1989, Resorts retained Alvarez & Marsal to review the company's business plan and to assist Resorts in restructuring. See 11/2/95 Tr. at 74-75. Thomas Ireland, a managing director of Alvarez & Marsal worked on the financial restructuring of Resorts in 1989. Ireland projected that Resorts would become unable to pay its debts as they matured sometime during the second half of 1989. 11/2/95 Tr. at 152. Alvarez &

Marsal recommended that Resorts announce a moratorium on the payment of interest on its bonds, and Resorts did so on August 28, 1989. 11/2/95 Tr. at 153.

On August 28, 1989, Merv Griffin, Chairman of Resorts sent a letter to bondholders notifying them of the moratorium and representing to the bondholders that Resorts "has sufficient cash-on-hand to meet its short-term debt obligations . . ." and representing that Resorts was in a stable financial position and had combined cash and credit resources of $100 million. Exh. 31. Griffin based his assessment of Resorts' financial condition on the fact that Morgan Guaranty Trust Company gave a commitment to Resorts for a $50 million line of credit based upon the value of Resorts' Showboat lease, which ultimately never came to fruition. Furthermore, Resorts had a $50 million demand note executed by TGC and guaranteed by Griffin available as capital. Ireland testified, however, that he did not believe TGC had sufficient assets to pay the note, but did not know details about Griffin's ability to satisfy the demand note. See 11/2/95 Tr. at 139-41.

Ireland testified that, in the summer of 1989, Resorts' liabilities exceeded the fair valuation of the company's assets at that time. Ireland defined "fair value" as an effort to value "the various pieces of [Resorts'] business, its assets at what those assets could be sold for at the time, and to compare that to what the company's liabilities were at the time." See 11/2/95 Tr. at 107. Ireland testified that Resorts' liabilities as of June 30, 1989 were $970 million, whereas the fair value of the company's assets in June 1989 ranged from $469 to $717 million. See 11/2/95 Tr. at 108, 112. Ireland testified that he attempted to close the gap between Resorts' assets and liabilities, but that he "couldn't even get close." See 11/2/95 Tr. at 112.

Resorts did not announce prior to August 1, 1989 that it or any of its subsidiaries were insolvent. Exh. 53, Response 46. Resorts did not represent as of August 1, 1989 that it or any of its subsidiaries were insolvent. Exh. 53, Response 47. On July 5, 1989 the Wall Street Journal printed an article entitled "Risky

Business: Merv Griffin's Plunge Into Casino Gambling Could Prove a Loser." See Exh. 20. The article detailed Resorts' financial problems, described the company's massive debt service and projected a decrease in value of certain bonds to less than 42 percent of their face value. The article also stated that Resorts had retained Salomon Brothers in May, a move that analysts viewed as a sign of Resorts' impending restructuring. Lowenschuss attached a copy of this article to his motion for reconsideration of the district court's dismissal of his appraisal action. Exh. 21.

Lowenschuss attached to his "Petition Requiring [Resorts] to pay $36.00 Merger Price" filed on July 13, 1989 in the district court a July 10, 1989 Wall Street Journal article entitled "Resorts Big Bondholders Form Panel as They Await Firm's Revamping Plan." See Exh. 22. The article described the formation of a committee of bondholders and a meeting of bondholders attended by Fred Lowenschuss. Fred Lowenschuss testified that he attended and spoke to the participants at the meeting, recommending that the bondholders put Resorts into bankruptcy forthwith. Exh. 46 at 69-70.

On August 28, 1990 this Court confirmed Resorts Second Amended Plan of Reorganization. Exh. 51. Under the confirmed plan the shareholders merger claims were treated as the equivalent of equity and received no distribution under the plan. Exh. 50 at 15, 31.

Procedural Posture

Lowenschuss filed for relief pursuant to Chapter 11 of the Bankruptcy Code in the District of Nevada on August 24, 1992, which stayed these proceedings until June 1994.

The U.S. District Court for the Eastern District of Pennsylvania, by Order entered April 17, 1995 by the Honorable John P. Fullam, U.S.D.J., transferred Laurance Lowenschuss' Pension Plan Action to the United States District Court for the District of New Jersey, pursuant to 28 U.S.C. § 1404(a).

By an Opinion of this Court dated May 17, 1995 and Order dated June 13, 1995, Lowenschuss, in his capacity as former trustee of the Pension Plan, was deemed to have been a party to the instant Adversary Proceeding from the inception of this action. By Order dated September 19, 1995, this Court severed Resorts' claims against Fred Lowenschuss individually and as Trustee of the Pension Plan, the Fred Lowenschuss, I.R.A. and the Laurance Lowenschuss, I.R.A. from those against Laurance Lowenschuss as successor Trustee of the Pension Plan and Laurance Lowenschuss, I.R.A. The trial in this action proceeded solely against the latter.

On October 23, 1995, Laurance Lowenschuss filed a motion for summary judgment as to Counts Four through Six of the Amended Complaint, Resorts' fraudulent transfer claims. This Court decided not to hear oral argument on the motion, but the arguments raised by Lowenschuss in his brief in support of granting summary judgment are fully considered herein.

This Court notes that the appraisal action instituted by Resorts in the Delaware Chancery Court was dismissed on May 1, 1991. Exh. 71. There is currently no pending action which would adjudicate the value of any Class A Resorts shares. Under Resorts' Second Amended Plan of Reorganization, any shareholder merger claims were treated as the equivalent of equity and received no distribution under the plan. Exh. 50 at 31.

Resorts and Laurance Lowenschuss, as current Trustee of Fred Lowenschuss Associates Pension Plan and on behalf of Laurance Lowenschuss, I.R.A., each filed pretrial briefs on or about October 26, 1995. Laurance Lowenschuss filed an amended pretrial brief on November 6, 1995, which also incorporated the memorandum of law filed on his behalf in support of Lowenschuss' motion for summary judgment as to Resorts' fraudulent transfer claims.

This Court conducted a trial on the Adversary Complaint on November 2 and 3, 1995. Laurance Lowenschuss filed post-trial "Proposed Findings of Fact and Conclusions of Law" on or about December 22, 1995. Resorts filed a post-trial brief on

December 26, 1995. On or about January 11, 1996, Resorts and Laurance Lowenschuss each filed post-trial reply briefs. The Court heard closing arguments in this adversary proceeding and reserved decision on February 29, 1996.

Section 105 Order

By Order dated June 16, 1992, this Court enjoined the transfer, dissipation, spending or disposal of $3,805,200 in funds held by Fred Lowenschuss in his individual capacity and as representative or trustee to the Fred Lowenschuss I.R.A., the Laurance Lowenschuss I.R.A. and the Fred Lowenschuss Associate Pension Plan. On August 26, 1994, Resorts moved for an order holding Laurance Lowenschuss and/or John Doe in contempt of this Court's June 16, 1992 Order. This Court directed an accounting of the Pension Plan by Order Dated October 20, 1994. The accounting order was vacated by the District Court for the District of New Jersey by Order dated January 30, 1995.

Following the trial, Resorts moved to increase the amount of the June 16, 1992 Order enjoining disposition of $3,805,200 in assets. The Pension Plan and Laurance Lowenschuss I.R.A. filed a cross-motion to dissolve the Order. This Court denied both Resorts' and Laurance Lowenschuss' motions.

DISCUSSION

I. COUNT ONE: MISTAKE

Resorts raises two alternative legal theories pursuant to which it seeks to recover the transferred funds: unilateral mistake of fact or mutual mistake of law.

A. Mistake of Fact

"It is considered unjust enrichment to permit the recipient of money paid under mistake of fact to keep it unless the circumstances are such that it would be inequitable to require its return." Great Am. Ins. Co. v. Yellen, 58 N.J. Super. 240, 246 (App. Div. 1959). Resorts asserts that it made a unilateral mistake of fact by paying Lowenschuss for his shares when the person who authorized transfer of funds to Chase did not physically see shares before payment and did not know the identity of the tendering shareholder at the time he authorized payment for the shares. Resorts also asserts that, even if O'Donnell knew that Lowenschuss was the shareholder who had tendered the shares, O'Donnell would still have transferred the funds because he did not have a list of the shareholders who had sought appraisal rights.

The defendant asserts that there was no basis for a mistake of fact because the tendered certificates were clearly marked and identified as being issued to the defendant. In addition, the defendant asserts that, even if O'Donnell never saw the stock certificates, Resorts was notified by Chase that Lowenschuss, the I.R.A. and Pension Plan were tendering their shares for payment. Chase routinely prepared and sent detailed stock transfer journal sheets to Resorts' administrative office, where O'Donnell worked, listing the names of former shareholders seeking to be paid the merger price. A transfer journal sheet dated July 26, 1989 and postmarked the following day specifically identifies the Pension Plan and I.R.A. as having surrendered a total of 105,700 shares. The defendant further asserts that, even if O'Donnell did not have a list of shareholders who sought appraisal, Christopher Whitney, Resorts' senior vice president and chief legal counsel, did have such a list of appraisal shareholders, as he attached such a list to his affidavit dated February 16, 1989, which was submitted in the Delaware Chancery Court appraisal action. Resorts learned of the improper payment to Lowenschuss and instituted this action to

rescind. Resorts issued no instructions to its own personnel or to its agents to prevent making illegal payments to certain tendering shareholders. See 11/3/95 Tr. at 49-50.

B. Mistake of Law

Resorts asserts that it paid Lowenschuss only because the Resorts employee responsible for transferring the money to the exchange agent was under the mistaken belief that Resorts was obligated to pay for all shares tendered, regardless of whether the holder had preserved his or her appraisal rights.

A mistake of law occurs only where "a person is truly acquainted with the existence or non-existence of facts, but is ignorant of or comes to an erroneous conclusion as to their legal effect." Flammia v. Maller, 66 N.J. Super. 440, 459 (App. Div. 1961). It is well settled under New Jersey law that a mistake of law, standing alone, is not a basis for recovery:

> [W] here an individual under a mistake of law, but with full knowledge of the facts, voluntarily pays money on a demand not legally enforceable against him, he cannot recover it in the absence of unjust enrichment, fraud, duress or improper conduct on the part of the payee.

Messner v. Union County, 34 N.J. 233, 235-36 (1961); see also Ross Systems v. Linden Dari-Delite, Inc., 35 N.J. 329, 334 (1961) ("It is well settled that money knowingly and voluntarily paid cannot be recovered on the ground there was no liability to pay in the first instance."); Flammia, 66 N.J. Super. at 459 ("The general rule is that payments made under a mistake of law or in ignorance of the law, but with full knowledge of the facts, cannot be recovered, absent fraud or improper conduct on the part of the payee."). Resorts asserts that O'Donnell did not make the payment solely as a result of a mistake of law, but also as a result of a mistake of fact.

Alternatively, Resorts alleges that the parties made a mutual mistake of law. Resorts asserts that both O'Donnell and Lowenschuss believed that Lowenschuss could tender his shares and Resorts could pay the merger price. The Trustee Fred Lowenschuss testified that, when he tendered his shares for payment in July 1989, he believed that he was entitled to the merger price under the terms of the Notice of Merger and Letter of Transmittal. See 11/3/95 Tr. at 227. Resorts further asserts that O'Donnell authorized the transfer of funds based on the mistaken belief that, pursuant to the merger agreement, all tendering shareholders were entitled to receive the merger price. See Combined Exhs. 42-43 at 59-60. Under New Jersey law, "a mutual mistake, whether of fact or law, will justify rescission of a contract provided that neither party . . . is irrevocably or substantially prejudiced." Springfield Township v. Board of Educ., 217 N.J. Super. 570, 580 (App. Div. 1987).

Here the Court finds that Resorts made a mistake of fact. Resorts' employees including its former Treasurer, Thomas O'Donnell, and its Chief Financial Officer, Matthew B. Kearney mistakenly believed that Resorts was obligated to pay $36.00 for all Resorts shares tendered.

C. Availability of a Remedy

As a threshold matter, this Court must determine whether the law accords any remedy to the plaintiff for the causes of action alleged herein. Resorts requests that this Court rescind the transaction whereby Lowenschuss tendered and Resorts accepted his shares of stock for $36 per share and order Lowenschuss to return to Resorts the $3,805,200.00 payment plus interest and Resorts to return the stock.

Under New Jersey and Pennsylvania law, courts generally will not enforce illegal contracts. Naimo v. LaFianza, 146 N.J. Super. 362, 369 (Law Div. 1976) ("A court of equity cannot enforce specific performance of a promise to make testamentary

gift to provide for a future-born illegitimate child where the parties violated the laws of the state in carrying out their contractual arrangement."); Naseef v. Cord, 90 N.J. Super. 135, 142 (App. Div.), aff'd 48 N.J. 317 (1966) ("If we were to enforce this contract, we would be aiding and abetting the violation of the ordinance. It is a rule of general application that any bargain is illegal if its formation or performance is prohibited by statute, and it will not be enforced in the courts."); Holst v. Butler, 379 Pa. 124, 131, 108 A.2d 740 (1954) ("Generally, a court will not lend its act to the enforcement of an illegal contract, but will leave the wrongdoers where it finds them.").

Resorts, however, does not seek enforcement of an illegal contract; but rather, rescission of the contract. Although there are no cases in New Jersey which are factually analogous to the case at hand, courts have stated, in dicta, that the general rule of law is for the court to leave the parties to an executed, illegal agreement where it finds them. For example, in Paley v. Barton Sav. & Loan Ass'n, 82 N.J. Super. 75 (App. Div.), cert. denied 41 N.J. 602 (1964), the New Jersey Appellate Court did not need to reach the conclusion that the agreement before it was illegal, but it assumed for the sake of argument that the agreement was illegal and stated:

> The law will not ordinarily assist either party to an illegal agreement. This was not an executory agreement, but one wholly executed by both sides. In the absence of some overriding effect upon the public interest, which this agreement does not involve (. . .), the law will leave the parties to such an executed agreement where it finds them.

Id. at 81-82 (citing Cameron v. International Alliance of Theatrical Stage Employees, 118 N.J. Eq. 11, 20 (E. & A. 1935))

In Lizak v. Rottenbucher, 140 N.J. Eq. 76, 79 (Ch. Div. 1947), the New Jersey Chancery Court stated:

> If the contract here implicated was essentially illegal (a point concerning which I need not express a decisive opinion), then the complainant does encounter the rule that our courts will not assist either party to enforce performance of, or to undo an illegal transaction.

The Lizak court quoted approvingly from its earlier decision in Auditorium Kennel Club v. Atlantic City, 16 N.J. Misc. 354 (1938):

> The same rule has been observed and followed by our Court of Chancery. Cases may, of course, be found in which Chancery has acted but has done so to protect the public welfare and to prevent the impending mischief which would arise from the performance of the illegal contract. In such cases equity has acted because the public interest required the relief. An acquaintance with our reported decisions on this subject discloses a continued adherence by our courts to the principle embodied in the common law maxim. The principle is to be recognized and regarded as a general rule of public policy. It is not difficult to discern in the decisions of our state a definite adoption of this policy and a disinclination to depart from it.

Lizak, 140 N.J. Eq. at 77-78.

1. Rescission

Rescission is appropriate where there is a mistake only where the plaintiff demonstrates that: (1) the mistake occurred despite reasonable care taken by the mistaken party; (2) the mistake was so great that enforcement is unconscionable; (3) the mistake relates to a material feature; and (4) rescission does not prejudice the defendant. See Intertech v. City of Paterson, 255

N.J. Super. 52, 60 (App. Div. 1992); Hamel v. Allstate Ins. Co., 233 N.J. Super. 502, 507 (App. Div. 1989).

a. Exercise of Reasonable Care

This Court first turns to the issue of whether Resorts made a mistake despite the exercise of reasonable care. As the New Jersey Supreme Court noted:

> "Mistake," by its very definition, implies some degree of negligence. Human failing is its essence and it denotes error of judgment. However, it still remains the obligation of a court of equity to determine whether, despite such misjudgment, it would be inequitable and fundamentally unjust not to set aside [the transaction].

Crane v. Bielski, 15 N.J. 342, 348 (1954). Whether the negligence of the mistaken party is of such a degree as to bar equitable relief depends on the particular circumstances of each case. Intertech v. City of Paterson, 255 N.J. Super. 52, 61 (App. Div. 1992). Delaware law requires Resorts to exercise the responsibility for supervising the surrender of shares for the merger consideration. The case of Alabama By-Products v. Cede & Co., 657 A.2d 254 (Del. 1995) is instructive. In Alabama By-Products, agents for shareholders who had exercised their appraisal rights inadvertently tendered shares for payment under the terms of the merger agreement. The beneficial owners of the stock brought suit against the acquiring corporation for the difference between the appraisal price and the merger price. The acquiring corporation argued, inter alia, that corporations should not be required to undertake the burden of investigating the potential appraisal status of every share that is surrendered to the corporation after a merger. The Delaware Supreme Court rejected that view, stating that "[o]nce appraisal rights are perfected, the corporation, as the official custodian of share ownership records, continues to exercise the

responsibility for supervising the surrender of shares for the merger consideration." 657 A.2d at 262. In Alabama By-Products, the Delaware Supreme Court held that because the agents' tender of shares in violation of Section 262 was not an effective termination of the appraisal action on behalf of the shareholders of the stock, the shareholders were entitled to receive the appraisal price for the shares.

Delaware law imposes upon the corporation the responsibility of overseeing the surrender of shares after a merger, including the duty to know the status of all of its shareholders. Id. Once appraisal rights have been perfected, the corporation is on notice of the shareholders who are dissenting from the merger, as well as the total number of shares that will be subject to the appraisal. Id. at 263. It is the corporation's obligation under Delaware law to prevent shareholders who have perfected their right to appraisal from tendering those shares in contravention of Section 262 (k). Id.

Resorts asserts that it exercised reasonable care in the way it handled the surrender of shares. Resorts is charged with the duty of knowing the status of its shareholders, and does not dispute that it knew that Lowenschuss was seeking appraisal. Resorts asserts that it fulfilled its duty to exercise reasonable care by notifying Lowenschuss, through its opposition to Lowenschuss' Petition for an order requiring Resorts to pay the merger price, that it did not intend to pay him the merger price.

This Court finds, however, that Resorts failed to exercise reasonable care when it authorized payment to Lowenschuss when he surrendered his shares. Resorts breached its duty to adequately supervise the surrender of shares for the merger consideration by failing to make even a cursory investigation as to the identity of the tendering shareholder and whether that shareholder had previously sought appraisal rights.

The record further demonstrates that Chase identified the Pension Plan and I.R.A. as tendering shareholders in a transfer journal sheet dated July 26, 1989, some five days before the date

Resorts authorized payment for the shares. Resorts failed to provide a list of appraisal shareholders to the employees responsible for payment upon surrender of the shares, nor did Resorts provide such a list to Chase. Even after learning of the illegal payment to Lowenschuss, Resorts failed to issue corrected instructions to Chase to cease all payments to appraisal shareholders who failed to obtain the requisite approvals pursuant to Section 262. The record demonstrates that Resorts paid other appraisal shareholders, even after Resorts' counsel notified Lowenschuss of his intent to recover the funds paid to Lowenschuss.

Accordingly, this Court finds that, even if the payment was the result of mistake, rescission is not appropriate because Resorts failed to exercise reasonable care to prevent the mistaken payment. Although this Court need not determine whether Resorts has fulfilled the other criteria for obtaining rescission of a mistaken payment, the Court will address those criteria because they further support this Court's finding.

b. Unconscionability of Enforcement

Resorts must also demonstrate that the mistake was so great that enforcement would be unconscionable. Resorts emphasizes the magnitude of compensation ($3,805,200.00) that the defendant received as a result of Resorts' actions. The Trustee asserts that, because the payment has already been made, maintaining status quo is not unconscionable. The Trustee asserts that Resorts is not prejudiced by the payment of $36.00 per share because Resorts carried on its books an item labelled "Liability to Former Shareholders," which provided for payment of all outstanding shares of Resorts in the amount of $36.00 per share.

The Trustee also asserts that rescission requires the court to restore the parties to the transaction to the position they each held prior to the transaction. See Intertech v. City of Paterson, 255 N.J. Super. 52, 59 (App. Div. 1992) (court must be able to return

parties to the "ground upon which they originally stood"); Hilton Hotels Corp. v. Piper Co., 214 N.J. Super. 328, 336 (Ch. Div. 1986) (same). However, complete restoration is not "an absolute requirement" and need only be done "so far as practicable." Notch View Assocs. v. Smith, 260 N.J. Super. 190, 198 (Law Div. 1992). The Trustee asserts that this Court cannot return the parties to status quo ante. Prior to the transaction, the Trustee was party to Resorts' appraisal proceeding in the Chancery Court in Delaware. There is currently no appraisal action pending in any court and the shares were cancelled by operation of law. Resorts proposes that this Court order rescission and return the shares of old Resorts to the Trustee and with them, his right to stand with the other shareholder merger claimants who received no distribution under Resorts' Second Amended Plan. Any effort to return these parties to the position they held before the transaction appears neither realistic nor fair. See Hilton Hotels, 214 N.J. Super. at 336.

c. Materiality

In order to rescind a transaction based on mistake, the mistake must relate to a material feature of the transaction. If Resorts in fact made a mistake, this Court is satisfied that the mistake formed the heart of the dispute between the parties -- that being whether the Trustee could obtain payment for his shares under the Merger Agreement and Delaware law?

d. Prejudice to Defendant

Resorts must also demonstrate that rescission would not unduly prejudice the defendant. The issue of whether or not the defendant would be prejudiced depends upon whether the defendant's position would be no worse after rescission of the transaction than it would have been had the transaction never occurred. See Hamel v. Allstate Ins. Co., 233 N.J. Super. 502, 509 (App. Div. 1989). Resorts asserts that the Trustee would not be

prejudiced by rescission because the Trustee would be returned to the same position as he was prior to the transaction -- in exchange for the return of the payment the Trustee received pursuant to an illegal transaction, the Trustee would receive back the shares of old Resorts and with them, his right to stand with the other shareholder merger claimants who did not tender as of November 3, 1989 the date Resorts ceased payments to all tendering shareholders. Nontendering shareholder merger claimants received no distribution under Resorts' Second Amended Plan of Reorganization.

The Trustee asserts that he is prejudiced by the events which have transpired since the tender and payment for shares. The Trustee points to the undisputed result of rescission -- the inability to obtain appraisal of the shares or payment of the merger price. The Trustee is foreclosed from obtaining any compensation whatsoever for the shares because the right to receive the merger price or seek appraisal was extinguished by operation of law. Accordingly, the Trustee asserts that, because old Resorts shares are presently valueless, rescission would effectively result in forfeiture by the Pension Plan and I.R.A.

The Trustee also asserts that rescission would be prejudicial because rescission would result in disparate treatment of similarly situated individuals. The Trustee presented evidence that at least one other shareholder David Dion perfected his appraisal rights and obtained payment without securing the requisite approvals. Dion was paid the merger price but, to date, was not required to return the funds totalling $3,600.00 to Resorts. The Trustee asserts that the Pension Plan and I.R.A. should not be treated differently than other similarly situated shareholders. This Court rejects the Trustee's assertion that Resorts' decision to bring suit against the Pension Plan and I.R.A., but not other similarly situated shareholders is unlawful. It is properly within Resorts' business judgment and discretion to prosecute any lawful action it deems necessary or expedient. This Court does not find that Resorts acted unlawfully or in bad faith because it chose to

prosecute some but not all shareholders who improperly obtained payment for their shares. There is arguably however, prejudice to the Trustee by the events that have transpired since the transaction that have effectively foreclosed his ability to obtain appraisal of the shares or payment of the merger price.

2. Restitution

There are exceptions to the principle that the law will not aid either party to an illegal contract. Many courts have ordered restitution despite an element of illegality in the transaction. The rationale behind many of these decisions is that the plaintiff was not in equal fault with the defendant, not in pari delicto. 2 George E. Palmer, The Law of Restitution, § 8.6, 203 (1978).

Restitution is warranted where one party is unjustly enriched at the expense of another. Restatement (First) of Restitution § 1 (1937); Wanaque Borough Sewerage Auth. v. Township of West Milford, 144 N.J. 564, 575 (1996). The Law of Restitution sets out three scenarios where the courts have granted restitution to the plaintiff based on a determination that the parties to the illegal contract were not in pari delicto: (a) where the defendant, apart from the illegality, committed a wrong; (b) where the plaintiff was ignorant of the illegality; or (c) where the law which rendered the transaction illegal was enacted for the benefit of the plaintiff. Palmer, supra, § 8.6 at 203-210.

The first scenario is where the defendant, apart from the illegality, committed a wrong. For example, the defendant used duress or misused a position of trust and confidence, or where the defendant acted fraudulently to induce the plaintiff to believe that the transaction was legal or to conceal or disguise the illegality. See United Security Life Ins. & Trust Co. v. Brown, 270 Pa. 273, 113 A. 447 (1921) (applicant for life insurance misrepresented his relationship to the person whose life was insured); Watson v. Poore, 18 Cal.2d 302, 115 P.2d 478 (1941) (In a suit to decree a purchase-money resulting trust, the defense that plaintiff had title

placed in defendant's name in order to defraud his creditors was rejected because the defendant had persuaded plaintiff to enter into the arrangement and was therefore, in greater fault).

The second category is where the plaintiff was ignorant of the illegality. For example, where the plaintiff was ignorant of the facts making the transaction illegal, and the defendant was not. See American Mut. Life Ins. Co. v. Bertram, 163 Ind. 51, 70 N.E. 258 (1904). The plaintiff's ignorance of the law which made the transaction illegal, however, does not suffice to render the plaintiff less culpable. An exception, however, has occurred where the law was an ordinance or regulation, which was difficult to ascertain and the other party was in a better position to know the law. See Maslo Mfg. Corp. v. Proctor Elec. Co., 376 Pa. 553, 103 A.2d 743 (1954), cert. denied, 348 U.S. 822 (1954). In addition, ignorance of the law will suffice when it was produced by the fraudulent misrepresentation of the other party. See American Mut. Life Ins. Co. v. Bertram, 70 N.E. at 262.

The last scenario is where the law rendering the conduct illegal was designed for the plaintiff's protection. For example, where the transaction is made illegal for the purpose of protecting one party against the other. Karamanou v. H. V. Green Co., 80 N.H. 420, 124 A. 373 (1922) (The court granted restitution to a purchaser of securities from an unlicensed dealer); Accord, Lund v. Cooper, 159 Ca. App.2d 349, 324 P.2d 62 (1958) Olson v. Thompson, 273 Minn. 152, 140 N.W.2d 321 (1966).

a. Separate Wrong Committed by Defendant

This Court is satisfied that the Trustee committed several wrongs wholly apart from the illegality of the transaction which demonstrate that the parties did not act in pari delicto. This Court finds that Lowenschuss tendered the shares with the knowledge that the shares were the subject of the Delaware Appraisal Action. Lowenschuss' testimony that he believed that he had an absolute right to tender the shares as he was not a party to Resorts' appraisal

action because he failed to deliver his shares to the Court within 60 days is not credible. Lowenschuss alleged in his Complaint filed in the district court in Pennsylvania that he had properly perfected his appraisal rights pursuant to Section 262 of the Delaware Code. Exhs. 9, 17 ¶ 58; see also 11/3/95 Tr. at 223. Yet, Lowenschuss never delivered his shares to that court to be marked "Not Negotiable." Lowenschuss also testified in his deposition that he knew that he could have obtained appraisal in the Delaware Chancery Court, but that he viewed the Delaware Chancery Court as an unfavorable forum and preferred not to litigate there. Exh. 68 at page 94-95; 11/3/95 Tr. at 231-32.

Furthermore, under Delaware law, an undisputed owner of shares may perfect his appraisal rights without surrendering the shares to be marked "Not Negotiable." In Alabama By-Products v. Cede & Co., 657 A.2d 254, 258 (Del. 1995), the Supreme Court of Delaware affirmed the Vice Chancellor's finding that an appraisal shareholder's failure to surrender the stock certificates does not prevent the uncontested owner of the shares from perfecting his appraisal rights. The Vice Chancellor stated that the purpose of surrendering stock certificates is to prove actual ownership of stock by each claimant. Where ownership of the stock is not contested, surrender of the stock certificates is not required in order to perfect appraisal rights. Id. Accordingly, this Court finds that the Trustee had perfected his appraisal rights, and that the Trustee had reasonable grounds to believe at the time of tendering his shares, that he had perfected his appraisal rights.

Even after he tendered the shares, Lowenschuss failed to notify Resorts or the Pennsylvania District Court of his earlier tender. The Trustee's assertion that the Petition and Request for Reconsideration filed in the District Court were effective to put Resorts and the District Court on notice of the Trustee's previous

tender of the shares[11] is not credible. On July 13, 1989, Lowenschuss filed a "Petition Requiring Resorts International, Inc. to Pay $36.00 Merger Price to Plaintiffs Immediately for 105,900 Shares of Resorts Class A Stock Owned by Plaintiffs and Which Are Hereby Being Tendered and to Complete the Record." Exh. 23. Lowenschuss' assertion that the verb tense used in the title and Paragraph 1 of the Petition should have put Resorts and the District Court on notice that the shares were "hereby being tendered" for "immediate exchange" at a rate of $36.00 per share cannot be credited. Nor does this Court find credible Lowenschuss' assertion that the accompanying memorandum of law filed with the Petition which requested that the District Court require Resorts to immediately accept and pay for the stock made clear that Lowenschuss was tendering the shares to Resorts. On July 17, 1989, Lowenschuss tendered the shares to Merrill Lynch for payment of the merger price. On July 19, 1989, the Trustee filed a reply memorandum entitled Request for Reconsideration and to Complete the Record and Plaintiff's Petition Requiring Resorts International, Inc. to Pay $36.00 Merger Price to Plaintiffs Immediately. Exh. 27. The Trustee stated therein that "Plaintiffs rather than post their stock, have tendered same for payment immediately of Thirty-Six ($36.00) per share." (emphasis added). Exh. 27 at p.5. This Court finds that the language of the Petition can only be interpreted as informing the Court that Lowenschuss was seeking a court-ordered, judicial remedy, not as simply a notice pleading informing the court and Resorts that he had already

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11 Fred Lowenschuss testified that his reply to Resorts' opposition to the Petition and motion for reconsideration was submitted to the district court in Pennsylvania for purposes of "explaining to [the Court and Resorts], in writing, exactly what was done." 11/3/95 Tr. at 186.

tendered the shares. The Trustee's overly-technical reading of the language of the motion papers cannot be credited.

Similarly, Lowenschuss' testimony that he relied on the Opinion of Vice Chancellor Hartnett in believing that he had an absolute right to tender the shares for payment and that he merely followed Resorts' instructions in the November 15, 1988 Notice of Merger and the Transmittal Letter must be rejected. In In re Resorts International Shareholders Litigation, 1988 WL 92749, at *6, *7 (Del. Ch. Sept. 7, 1988), aff'd 570 A.2d 259 (Del. Super. 1990), Vice Chancellor Hartnett approved, over objection, an Amended Settlement which included a provision barring all class members from asserting unfair dealing claims (i.e, "Rabkin claims") against Resorts and its directors. Exh. 5. Vice Chancellor Hartnett determined that non-tendering Resorts' shareholders obtained a "benefit" from the proposed Amended Settlement, the opportunity to waive appraisal rights and obtain payment of the merger price. Vice Chancellor Hartnett's opinion does not purport to modify in any way the statutory requirements for withdrawing as a litigant from an appraisal proceeding. Accordingly, this Court finds that Lowenschuss could not reasonably have relied upon Vice Chancellor Hartnett's opinion as authorizing the tender of his shares without complying with the requirements of Section 262.

This Court finds that the Trustee committed several wrongs apart from the illegality of the transaction. Accordingly, as this Court finds that Resorts made the payment as the result of a mistake, Resorts is entitled to restitution from the Trustee in the amount of $3,805,200.00.

II. COUNT TWO: LEGAL AND EQUITABLE FRAUD

A. Legal Fraud

In order to set forth a prima facie case for legal fraud under New Jersey law, a plaintiff must prove: (1) that the defendant made a material misrepresentation of a presently existing or past fact; (2) which the defendant knew or believed to be false; (3) upon which the defendant intended the plaintiff to rely; (4) and upon which the plaintiff did reasonably rely; and (5) was damaged thereby. Gennari v. Weichert, 288 N.J. Super. 504, 535 (App. Div. 1996); Jewish Ctr. of Sussex County v. Whale, 86 N.J. 619, 624 (1981). The party alleging legal or equitable fraud must prove each element by clear and convincing evidence. See Stochastic Decisions, Inc. v. DiDomenico, 236 N.J. Super. 388, 395 (App. Div. 1989), certif. denied, 121 N.J. 607 (1990).

1. Material misrepresentation

To establish legal fraud under New Jersey law, Resorts must prove by clear and convincing evidence that the defendant made a material misrepresentation of a presently existing or past fact. Resorts asserts that the Trustee, in fact, made several misrepresentations. Resorts asserts that Fred Lowenschuss misrepresented in Paragraph 12 of his reply memorandum to Resorts' opposition to his Petition that he could have his stock certificates marked "Not Negotiable." Exh. 27. Resorts also asserts that, through pleadings and by tendering the shares, the Trustee misrepresented that he was permitted to seek the merger price. Resorts further asserts that the Trustee misrepresented to Resorts and to the district court that he was seeking a judicial remedy by tendering shares to the court, and would await the court's decision regarding his motion for reconsideration. Finally,

Resorts asserts that the Trustee's failure to inform Resorts and the district court or the Chancery Court in Delaware court of the tender to Merrill Lynch constituted another misrepresentation. This Court finds that the Trustee made these material misrepresentations.

The Trustee proffers that Fred Lowenschuss made no misrepresentations, as he acted in accordance with the November 15, 1988 Notice of Merger and the Transmittal Letter, both of which entitled him to tender shares. Exhs. 7, 7A. The Trustee asserts that the reply papers submitted on the Trustee's behalf with respect to the motion for reconsideration of the dismissal order were effective to put Resorts on notice of the Trustee's previous tender of the shares. Exh. 23, 27. The Trustee also asserts that he had an absolute right to tender the shares, as he was not a party to Resorts' appraisal action because he failed to deliver the shares to the Court within 60 days. Under Delaware law, an appraisal proceeding may be dismissed for failure to deliver the shares to be marked "Not Negotiable." See Exh. 13, ¶ 8; Exh. 16.

In Alabama By-Products v. Cede & Co., 657 A.2d 254, 258 (Del. 1995), the Supreme Court of Delaware affirmed the Vice Chancellor's finding that an appraisal shareholder's failure to surrender the stock certificates does not prevent the uncontested owner of the shares from perfecting his appraisal rights. The Vice Chancellor stated that the purpose of surrendering stock certificates is to prove actual ownership of stock by each claimant. Where ownership of the stock is not contested, surrender of the stock certificates is not required in order to perfect appraisal rights. Id.

2. Knowledge of Falsity

This Court is satisfied that the Trustee knowingly, misrepresented to Resorts that he was entitled to tender his shares for payment. This Court is satisfied that the Trustee tendered the shares knowing that they were subject to an appraisal proceeding

and that the Trustee knowingly concealed from the district court the fact of his tender. Fred Lowenschuss testified that he read the proxy statement which set forth the limitations on his ability to withdraw his appraisal rights and which attached the full text of Section 262 of the Delaware Code. See 11/3/95 Tr. at 205-07. The fact that the Trustee properly perfected his appraisal rights and understood that he had done so supports this Court's finding that the Trustee made material misrepresentations knowing that those representations were false. Furthermore, at the time of the transaction, Fred Lowenschuss was a sophisticated business person. Fred Lowenschuss was at the time of trial a lawyer for approximately 39 years (11/3/95 Tr. at 186), and he had experience litigating shareholders' rights actions under Delaware law. Fred Lowenschuss was also a successful investor for the Pension Plan and IRAs. The Pension Plan at one point had a net asset value of over $10 million. See 11/3/95 Tr. at 187.

In his Petition dated July 13, 1989, Lowenschuss stated that he was "hereby tendering" all of his shares for "immediate payment of the merger price of Thirty-six Dollars ($36.00) per share plus the interest which plaintiffs may be entitled to." Exh. 23. By requesting a court order and a payment of interest (which only a court could order), the Trustee not only led Resorts and the Pennsylvania court to believe that he was placing his shares in the custody of the court, but he acknowledged his understanding that he could not receive the merger price without the express approval of a court.

This Court finds that the Trustee tendered the shares knowing that they were subject to an appraisal proceeding and that the Trustee knowingly concealed from the district court the fact of his tender. Accordingly, the Court is satisfied that the Trustee knew that his representation on July 17, 1989 that he was entitled to be paid the merger price for his shares was false.

3. Scienter

Scienter is defined as the "knowledge of the falsity and an intention to obtain an undue advantage therefrom." Jewish Ctr., 86 N.J. Super. at 625. This Court finds that Fred Lowenschuss made the representations with the intent to obtain an undue advantage over Resorts. By representing on July 13, 1989 to Resorts and the district court that he was submitting to the jurisdiction of the district court to obtain an order requiring Resorts to pay the merger price for his shares and tendering the shares just four days later on July 17, 1989, Lowenschuss made knowing, intentional and deliberate misrepresentations to Resorts and the district court and intended to lull Resorts into believing that he would await a judicial remedy while he tendered the shares and obtained payment for same.

4. Actual Reliance

Resorts authorized payment for the shares owned by the Pension Plan and IRA in reliance upon Lowenschuss' misrepresentations.

The Trustee asserts that, even if the Trustee made misrepresentations, Resorts did not rely upon Fred Lowenschuss' representations when it authorized payment for the shares. The Trustee asserts that Resorts, under the assumption that all shareholders who tendered shares were to be paid, paid all tendering shareholders, regardless of whether the shareholder sought appraisal rights. Furthermore, Resorts authorized payment to other appraisal shareholders, including David Dion, even after Lowenschuss was paid and Resorts had instituted the present action to recover the funds.

Resorts relied upon the Trustee's representation to the Pennsylvania District Court that the Trustee was seeking a judicial

remedy - that the District Court reinstate the Trustee's appraisal proceeding and rule thereupon.

Christopher Whitney, Resorts former General Counsel testified that he understood at the time of Lowenschuss' tender of the shares that Lowenschuss had declined the merger price and was proceeding with the matter in the courts and further that it never occurred to him, Whitney, that anyone would invoke appraisal rights and also seek to be paid the merger price. Tr. 11/2/95 at 218-219, 240. Resorts reliance was both reasonable and justifiable given the Trustee's numerous misrepresentations to Resorts and to the Pennsylvania District Court that he was seeking a judicial remedy as to the Trustee's shares.

5. Damages

In order to recover the transferred funds, Resorts must also demonstrate that it was damaged as a result of the fraud perpetrated by the Trustee.

The Trustee asserts that any damage to Resorts resulted from its failure to properly instruct its representatives and agents about the requirements of Section 262 and not the Trustee's unlawful tender. Kearney testified that, until November 3, 1989, Resorts paid every shareholder who tendered, regardless of whether or not the shareholder had previously sought appraisal rights. See 11/3/95 Tr. at 104.

The Trustee also asserts that Resorts was not harmed because Resorts carried on its books a "Liability to Former Shareholders," which provided for payment of all outstanding shares of Resorts in the amount of $36.00 per share. This Court rejects the Trustee's assertion that, because Resorts appropriated funds to pay former shareholders who lawfully tendered their shares, Resorts was not harmed by paying an equal amount to Lowenschuss, a shareholder who unlawfully tendered his shares.

Accordingly, this Court finds that Resorts was damaged in the amount of $3,805,200.

B. Equitable Fraud

To prove equitable fraud under New Jersey law, the plaintiff must prove all of the elements of legal fraud with the exception of scienter. Equitable fraud is a more inclusive doctrine than legal fraud. "Whatever would be fraudulent at law will be so in equity, but the equitable doctrine goes farther and includes instances of fraudulent misrepresentations which do not exist in the law." Jewish Ctr., 86 N.J. at 625 (citing 3 J. Pomeroy, A Treatise on Equity Jurisprudence 486-88). Equitable fraud includes "all acts, omissions or concealment which involve a breach of a legal or equitable duty, trust or confidence justly reposed and are injurious to another, or by which an undue or unconscientious advantage is taken of another." Walensky v. Jonathan Royce Int'l., Inc., 264 N.J. Super. 276, 283 (App. Div. 1993) (quoting Macfadden v. Macfadden, 49 N.J. Super. 356, 360 (App. Div.), certif. denied 27 N.J. 155 (1958)). Insofar as this Court has already determined that the Trustee committed legal fraud when he unlawfully tendered his shares, this Court will also enter judgment in the amount of $3,805,200.00 against the Trustee for equitable fraud.

III. COUNT FOUR: FRAUDULENT CONVEYANCE UNDER 11 U.S.C. § 548(a)

A. Fraudulent Conveyance Under Section 548(a)(1)

Count Four of Resorts' Amended Complaint asserts that the transaction is voidable as a fraudulent conveyance pursuant to Section 548(a) (1) of the Bankruptcy Code.[12]

In order to set forth a prima facie avoidance action pursuant to Section 548 (a) (1), Resorts must demonstrate several things: that what was transferred was an interest in property of the debtor, that there was a transfer of that interest, that such transfer occurred within one year of the date of the filing of the petition, and that the debtor intended to hinder, delay or defraud another by making the transfer.

This Court is satisfied that the first three criteria for a voidable fraudulent transfer are present: although the route of the transferred fund is circuitous, it is undeniable that the transaction at issue here involved the transfer of $3,805,200 of the debtor's funds to the Trustee. The Trustee acknowledges receipt of $3,805,200 as payment for the Resorts stock which he tendered. It

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12 Section 548(a) (1) of the Bankruptcy Code provides:

> (a) The Trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily --
>
> > (1) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted.

11 U.S.C. § 548(a) (1).

is also undisputed that the transaction occurred within one year of the filing of Resorts' bankruptcy petition.

To avoid a transaction as fraudulent under Section 548 (a) (1), the trustee or debtor-in-possession must demonstrate that the debtor had the requisite intent to hinder, delay or defraud creditors. It is the debtor's intention, rather than the transferee's intention, which determines whether a transfer is fraudulent under Section 548(a) (1). See In re Rubin Bros. Footwear. Inc., 119 B.R. 416, 423 (S.D.N.Y. 1990); In re Auto Specialties Mfg. Co., 153 B.R. 457 (Bankr. W.D. Mich.), adopted in part 153 B.R. 503 (W.D. Mich. 1993). There is no evidence in the record to indicate, nor does the amended Complaint allege, that Resorts ever intended to hinder, delay or defraud creditors.

Under certain circumstances the intent of the transferee may be substituted for the intent of the debtor. For example, where the transferee dominates or controls the debtor's disposition of his property the transferee's intent be imputed to the debtor to render the transfer fraudulent pursuant to Section 548(a)(1). In re Sackman Mortgage Corp., 158 B.R. 926, 938 (Bankr. S.D.N.Y. 1993); In re Rubin Bros. Footwear, Inc., 119 B.R. 416, 423 (S.D.N.Y. 1990); In re Formaggio, Inc., 23 B.R. 688, 691 (Bankr. W.D. Wis. 1982). The typical case where intent of the transferee may be substituted for that of the transferor involves a transferee who dominates or controls the debtor by its position as an insider. In re F & C Serv., 44 B.R. 863, 872 (Bankr. S.D. Fla. 1984) (transferee was alter ego of debtor created by debtor's majority shareholder and chairman); In re Formaggio Mfg., Inc., 23 B.R. 688, 691 (Bankr. D.R.I. 1982) (transferee was president); In re Vaniman Int'l. Inc., 22 B.R. 166, 182-83 (Bankr. E.D.N.Y. 1982) (transferees were principal officers).

Resorts alleges that the Trustee's alleged fraudulent intent should be imputed to Resorts, as Lowenschuss, through trickery, positioned himself to control Resorts' disposition of property. The Trustee asserts that Fred Lowenschuss did not exercise control over Resorts and that, even if Lowenschuss had a fraudulent intent,

such intent could not be substituted for Resorts' intent. In support of his assertion that Lowenschuss did not exercise control over Resorts with respect to the transfer, the Trustee points to the undisputed fact that Resorts transferred funds to whomever tendered regardless of identity or whether appraisal sought. The Court finds that Resorts has failed to demonstrate that the Trustee sufficiently controlled the action of the debtor Resorts to impute the intentions of the Trustee to Resorts. Accordingly, Resorts may not avoid the transaction as a fraudulent conveyance under 11 U.S.C. §548 (a) (1).

B. Fraudulent Conveyance Under Section 548(a)(2)

Count V of the Amended Complaint seeks avoidance of the transfer as a fraudulent conveyance under Section 548(a) (2) of the Bankruptcy Code.[13]

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[13] Section 548(a) (2) of the Bankruptcy Code provides:

> (a) The Trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily --
>
> (2) (A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
>
> (B) (i) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

[Footnote continued on next page]

The Trustee raises a threshold issue with respect to Count V (constructive fraudulent transfer claim pursuant to 11 U.S.C. §548(a) (2)) and Count VI (constructive fraudulent transfer claim pursuant to N.J.Stat. Ann §§ 25:2-25(b) and 25:2-27(a)) avoidance of the transaction as fraudulent pursuant to Section 548 (a) (2). The Trustee asserts that the $3,805,200 payment received by the Trustee was a "settlement payment" as defined by Section 741 of the Bankruptcy Code, which may not be avoided by the debtor-in-possession by avoiding the transaction as fraudulent. See 11 U.S.C. § 546(e); see also Bevill, Bresler & Schulmar Asset Management Corp. v. Spencer Sav. & Loan Ass'n, 878 F.2d 742, 747 (3d Cir. 1989). Section 546(e) of the Bankruptcy Code provides:

> Notwithstanding sections 544, 545, 547, 548(a) (2), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 101, 741, or 761 of this title, or settlement payment, as defined in section 101 or 741 of this title, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or

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[Footnote continued from previous page]

> (ii) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or
>
> (iii) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured.

11 U.S.C. § 548(a) (2).

> securities clearing agency, that is made before the commencement of the case, except under section 548(a) (1) of this title.

11 U.S.C. § 546(e). In section 546(e) of the Bankruptcy Code, Congress has exempted a payment made by or to a stockbroker in exchange for the tender of securities as part of an LBO from the application of fraudulent transfer law under the Bankruptcy Code. The Trustee asserts that Resorts permitted Chase, its paying agent, to transfer $3,805,200 to Merrill Lynch, the stockbroker for the Pension Plan and the I.R.A., in exchange for the tender of their shares.

The Trustee asserts that the payment by Chase for the tendered shares constitutes a settlement payment under section 546(e). Section 741(8) of the Code defines a settlement payment as follows: "a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement or another similar payment commonly used in the securities trade." At the time section 546(e) was passed, Congress' stated intent was to protect the commodities and securities market by preventing the insolvency of one commodities or securities firm from spreading to other firms thereby preventing the collapse of the affected market. Bevill, Bresler, 878 F.2d at 747 (citing H.R. Rep. No. 97-420, at 1 (1982)). Congress intended to protect participants in the securities markets generally from being forced to disgorge funds in a bankruptcy proceeding. Id. The consummation of a leveraged buy out ("LBO") is one of the securities transactions to which Section 546(e) applies. Kaiser Steel Corp. v. Pearl Brewing Co., 952 F.2d 1230, 1239-40 (10th Cir. 1991), cert. denied, 505 U.S. 1213 (1992). Consequently, a beneficial shareholder who receives a settlement payment from its stockbroker in exchange for the tender of shares in an LBO is protected from avoidance actions under Sections 544 and 548(a) (2). Id. at 1240-41.

Resorts asserts that Section 546(e) does not apply to the situation presented herein because the $3,805,200 payment did not constitute a "settlement payment" for purposes of Section 546 (e). Resorts asserts that, once the Trustee had perfected his appraisal rights, the Trustee transformed his right to tender the shares into a right to obtain judicial appraisal of those shares. See Alabama By-Products, 657 A.2d at 261, 263, 266-67.

Resorts further asserts that Bevill, Bresler and Kaiser Steel are inapposite. The court in Bevill, Bresler found that Section 546(f) of the Bankruptcy Code applies to "repo" transactions that are settled through the delivery of securities later than five days after performance is otherwise complete. Kaiser Steel found that Section 546(e) of the Bankruptcy Code applies to a valid tender, by all beneficial owners, of equity securities for consideration in the context of an LBO. 878 F.2d at 752-753.

Resorts relies upon In re Weiboldt Stores, Inc., 131 B.R. 655, 664 (N.D. Ill. 1991), wherein the district court found that Section 546(e) applies only when the relief sought "poses a significant threat to those in the clearance and settlement chain." However, the Tenth Circuit rejected the narrow interpretation reached by the district court in Weiboldt. The Tenth Circuit reasoned that:

> Given the wide scope and variety of securities transactions, we will not interpret the term settlement payment so narrowly so as to exclude the exchange of stock for consideration in an LBO. . . . there is no reason to narrow the plain concept of settlement payment to a single type of securities transaction.

Kaiser Steel, 952 F.2d at 1240.

The Tenth Circuit further stated that:

> On its face, the statute is clear. The statute exempts payments made 'by or to' a stockbroker financial institution, or clearing

> agency. Again, unless there is some reason to believe the clear application is abused and otherwise unreasonable we leave our inquiry at that.

952 F.2d at 1239. Accordingly, this Court finds that Section 546(e) bars Resorts from asserting constructive fraud claims under Section 548(a) (2) and state law, N.J.S.A. § 25:2-25(b) and 25:2-27 (a).

IV. COUNT SIX: FRAUDULENT CONVEYANCE UNDER NEW JERSEY LAW

Pursuant to Sections 544(b) and 1107(a) of the Bankruptcy Code, a debtor in possession may avoid any transfer of property that could be avoided by its creditors as a fraudulent conveyance under state law. Section 544 (b) provides:

> The trustee may avoid any transfer of an interest of the debtor in property that is voidable under applicable law by a creditor holding an unsecured claim . . .

11 U.S.C. § 544(b).

A. Fraudulent Conveyance Under N.J.S.A. 25:2-25

As noted above pursuant to Section 544, Count VI asserts constructive fraudulent transfer claims under N.J.S.A. § 25:2-25 (b). Section 546(e) similarly bars Resorts from asserting a constructive fraudulent transfer claim under N.J.S.A. § 25:2-25(b). As to Resorts state law claim for actual fraud under N.J.S.A.

25:2-25(a),[14] like avoidance actions under Section 548 (a) (1), fraudulent conveyance actions under New Jersey state law require that the debtor possess actual intent to hinder, delay, or defraud creditors at the time of making the transfer. The focus is on the debtor's fraudulent intent, not the transferee's intent. Under certain circumstances, a transferee's fraudulent intent may be imputed to a debtor-transferor. Francis v. United Jersey Bank, 162 N.J. Super. 355, 367-68 (Law. Div. 1978), aff'd 171 N.J. Super. 34 (App. Div. 1979), aff'd 87 N.J. 15 (1980). This Court has already found that Resorts failed to demonstrate that the Trustee sufficiently controlled the actions of the debtor to impute the intention of the Trustee to Resorts. See, supra, Section III.A. Accordingly, Resorts may not avoid the transaction as a fraudulent conveyance pursuant to N.J.S.A. § 25:2-25(a).

V. AFFIRMATIVE DEFENSES

The Trustee has asserted several affirmative defenses in an effort to bar Resorts from recovering the funds. The Trustee asserts that Resorts is equitably estopped from recovering the funds, alleging that the Notice of Merger and Letter of Transmittal instructed appraisal shareholders that they could withdraw their

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[14] N.J.S.A. 2:2-25 provides:

> A transfer made . . . a debtor is fraudulent [as to present and future creditors] if the debtor made the transfer. . . :
>
> a. With actual intent to hinder, delay, or defraud any creditor of the debtor.
>
> N.J. Stat. Ann. § 25:2-25 (West 1996).

appraisal action simply by tendering their shares. This Court has already found that the Notice of Merger and Letter of Transmittal did not modify the statutory procedure for withdrawing a demand for appraisal and tendering shares for payment.

The Trustee further asserts that Resorts is prosecuting the present action in bad faith. The Trustee points to the fact that Resorts has not instituted an action against similarly situated shareholders to recover monies paid in violation of Section 262. The Trustee alleges that Resorts' decision to prosecute this action against the Trustee, but not other appraisal shareholders who tendered illegally, demonstrates Resorts' bad faith. This Court is satisfied that Resorts did not prosecute this action in bad faith. So long as Resorts and its counsel act within the confines of the applicable civil practice rules, it is properly within Resorts' business judgment and discretion to prosecute any action it deems necessary or expedient. This Court does not find that Resorts acted in bad faith because it chose to proceed against some but not all shareholders who improperly obtained payment for their shares.

This Court similarly rejects the Trustee's assertion that Resorts has unclean hands. The Trustee asserts that Resorts' counsel had knowledge of the requirements of Section 262 and that counsel's knowledge must be imputed to Resorts' employees. There is no evidence in the record to indicate that Resorts comes to this Court with unclean hands. "The doctrine of unclean hands embraces the principle that a court should not grant equitable relief to a party who is a wrongdoer with respect to the subject matter of the suit." Pellitteri v. Pellitteri, 266 N.J. Super. 56, 65 (App. Div. 1993) (citing Faustin v. Lewis, 85 N.J. 507, 511 (1981)). The unclean hands doctrine "calls for exercise of careful and just discretion where a suitor is guilty of bad faith, fraud or unconscionable acts in the underlying transaction." Id. (citing Untermann v. Untermann, 19 N.J. 507, 517-18 (1955)). This Court finds no wrongdoing, bad faith, fraud or unconscionable acts on the part of Resorts. Accordingly, the Trustee's affirmative defense of unclean hands is without merit.

The Trustee further asserts that the Trustee waived his right of appraisal upon tendering the shares. The Trustee has never before asserted this affirmative defense in any of his pleadings, in any motion before this Court, or during trial. Accordingly, the Trustee has waived the affirmative defense of waiver and may not assert it now. Kilbarr Corp. v. Business Systems Inc., B.V., 679 F. Supp. 422, 428 (D.N.J. 1988), aff'd 869 F.2d 589 (3d Cir. 1989) (affirmative defenses are waived if not raised in a pleading, by motion, or at trial).

The Trustee further asserts that the tender of shares and payment therefor was a settlement to which Resorts is bound. The Trustee asserts that, once appraisal was sought, the Trustee had a claim against Resorts and that Resorts misconstrues the nature of the defendant's appraisal claims, apparently believing that they are the equivalent of equity rather than a debt of Resorts, citing UMS Partners Ltd. v. Jackson, 1995 WL 413395, at *4-5 (Del. Super. 1995). Resorts asserts that the shares had no value because of the insolvent nature of Resorts. The court finds that the Trustee here, a shareholder with perfected appraisal rights, was bound by the judgement in the appraisal action. Alabama By-Products, 657 A.2d at 264. Chase's acceptance of the Trustee's shares and remittance of the merger price did not satisfy the specific statutory requirements of Delaware General Corporate Law Section 252(k) that prohibits a shareholder, in certain circumstances, from withdrawing from a pending appraisal proceeding without (1) receiving the consent of the surviving corporation and (2) obtaining an order of dismissal from the court.

The Trustee asserts that Resorts lacks standing to assert an action to recover the funds from the Trustee. The Trustee asserts that if any party has been harmed by the illegal transaction, it is GRI, not Resorts. The record indicates, however, that it was Resorts that carried the untendered shares of old Resorts stock on its balance sheet. 11/2/95 Tr. at 165-166. It was Resorts that made the $3.8 million payment to the Trustee. Accordingly, this Court finds that Resorts has standing to seek recovery of the funds from

the Trustee, as it was Resorts' funds from which the Trustee was paid.

VI. PREJUDGMENT INTEREST

The Court also agrees with Resorts that it is entitled to prejudgment interest from the actual date of loss, August 3, 1989. McAdam v. Dean Witter Reynolds, Inc., 896 F.2d 750, 773 (3d Cir. 1990) (the authority to suspend the running of prejudgment interest should be most cautiously exercised, and always with consideration of the underlying purpose and philosophy of the rule - namely that prejudgment interest is not a penalty but is rather a payment for the use of money). In New Jersey, the award of prejudgment interest in tort cases is governed by New Jersey Court Rule 4:42-11. Stella v. Dean Witter Reynolds, Inc., 241 N.J. Super. 55, 76-77 (App. Div.), certif. denied, 122 N.J. 418 (1990) (party entitled to prejudgment interest on his recovery for fraud at the rates fixed by R. 4:42-11(b)). In part, rule 4:42-11 provides:

> commencing January 2, 1986 and for each calendar year thereafter, the annual rate of [prejudgment] interest shall equal the average rate of return, to the nearest whole or one-half percent, for the corresponding preceding fiscal year terminating on June 30, of the State of New Jersey Cash Management Fund (State accounts) as reported by the Division of Investment in the Department of the Treasury.

N.J. Civ. Prac. R. 4:42-11. The annual rate of interest for calendar year 1989 was 7%; the rate for calendar year 1990 was 8%; the rate for calendar year 1991 was 8.5%; the rate for calendar year 1992 was 7.5%; the rate for calendar year 1993 was 5.5%; the rate for calendar year 1994 was 3.5%; the rate for calendar year 1996 was 5.5%; the rate for calendar year 1997 is 5.5%. Id. (publisher's note). Accordingly, this Court will grant Resorts interest at the beforementioned rate on the $3,805,200.00 award.

VII. PUNITIVE DAMAGES

This Court will now address the issue of punitive damages. As Resorts has demonstrated that Lowenschuss committed legal fraud, Resorts may be entitled to an award of punitive damages. Punitive damages are awarded as punishment or deterrence for particularly egregious conduct. See Nappe v. Anschelewitz, Barr, Ansell & Bonello, 97 N.J. 37, 50 (1984). To warrant a punitive award, the defendant's conduct must have been wantonly reckless or malicious. There must be an intentional wrongdoing in the sense of an "evil-minded act" or an act accompanied by a wanton and willful disregard of the rights of another. Id. at 49. The key to the right to punitive damages is the wrongfulness of the intentional act. The right to award exemplary damages primarily rests upon the single ground - wrongful motive. Id. As noted by the court in Nappe, "it is especially fitting to allow punitive damages for actions such as legal fraud since intent rather than mere negligence is the requisite state of mind" Id. at 50. See also Berg v. Reaction Motors Div., Thiokol Chem. Corp., 37 N.J. 396, 414 (1962) (plaintiff entitled to punitive damages upon a "showing that there has been a deliberate act or omission with knowledge of a high degree of probability of harm and reckless indifference to consequences"). In assessing punitive damages, courts must consider all the circumstances surrounding the transaction, the intent of the wrongdoer and the nature of the wrongdoing, the extent of harm to the victim and its creditors, the wrongdoer's financial condition, the victim's litigation expenses, and the deterrent effect of such an award on potential offenders. See Herman v. Sunshine Chem. Specialties. Inc., 133 N.J. 329, 338-39 (1993); Leimgruber v. Claridge Assocs., Ltd., 73 N.J. 450, 454, 456 (1977). Despite the lack of an established standard by which the amount of punitive damages may be fixed, the general doctrine is that exemplary damages awarded must bear some reasonable relationship to the injury inflicted and the cause of the injury

without ignoring other factors such as the egregious nature of the offense. Leimgruber, 73 N.J. at 457-458.

Here, this Court believes that the facts and circumstances surrounding the Trustee's knowing, intentional and deliberate misrepresentations, both to Resorts and to the Pennsylvania District Court, see infra pp. 40-50, warrant the imposition of punitive damages.[15] The conduct of the Trustee has, heretofore, been found to consist of knowing, intentional and deliberate misrepresentations to Resorts and the Pennsylvania district court. Such conduct was malevolent in nature, and meets the standard of 'a deliberate act or omission with knowledge of a high degree of probability of harm and reckless indifference to consequences'. The punishment and deterrence policies underlying exemplary damages are served by an award of punitive damages. At closing arguments after the close of trial, Resorts requested punitive damages of $10 million. Resorts urged that given the original amount in controversy of approximately $3.8 million, plus prejudgment interest which arguably would increase the award to the $5 million range, a punitive damage award of $10 million would represent a two-time multiplier of the award in controversy. See Transcript of February 29, 1996 at p. 28.

This Court, considering all the circumstances surrounding the transaction, finds that the amount of punitive damages against

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15 Contrary to Lowenschuss' proffer, this Court need not conduct a separate hearing in order to impose punitive damages. The defendant's reliance on Herman v. Sunshine Chem. Spec., Inc., 133 N.J. 329, 342 (1993) is misplaced. The Herman case dealt exclusively with punitive damages in products liability actions under N.J.S.A. 58:C-1 to 7 (the Act), which Act mandates a bifurcated proceeding as to punitive damages under N.J.S.A. 2A:58C-5(b).

the Trustee which is appropriate, without being unduly excessive and consistent with the harm caused, is $250,000.

To the extent that the Trustee seeks reconsideration of this Court's Opinion dated June 13, 1995, whereby the Pension Plan was held to have been a party to this action since its inception, that motion is denied. This Court's ruling was affirmed on appeal to the District Court and is now the law of this case. This Court also denies a request made by counsel for Laurance Lowenschuss in a March 14, 1997 letter submission to reconsider its July 26, 1991 Report and Recommendation to the United States District Court for the District of New Jersey pursuant to Bankruptcy Rule 9027(e) and Bankruptcy Rule 5011(b) as it concerns the validity of the removal of the instant adversary proceeding to this Court from the United States District Court for the Eastern District of Pennsylvania. The Court here notes that by order dated November 8, 1991 that Report and Recommendation was adopted by the United States District Court for the District of New Jersey by order of District Judge Stanley S. Brotman, U.S.D.J. The Trustee's request by letter is procedurally improper and will be denied.

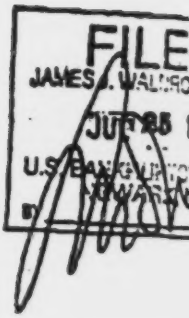
An order and judgment shall be submitted in accordance with this Opinion.

Dated: April 22, 1997

/s/

ROSEMARY GAMBARDELLA
UNITED STATES BANKRUPTCY
JUDGE

APPENDIX D



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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW JERSEY

In re:	:	Hon. Rosemary Gambardella
RESORTS INTERNATIONAL, INC.,	:	
RESORTS INTERNATIONAL FINANCING , INC.,	:	Chapter 11
GRIFFIN RESORTS INC., and	:	Case Nos. 89-10119
GRIFFIN RESORTS HOLDING, INC.,	:	89-10120
	:	89-10461
Debtors.:		89-10462

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RESORTS INTERNATIONAL, INC.,	:	Adv. Pro. No. 90-1005
Plaintiff,	:	
v.	:	
FRED LOWENSCHUSS, individually and as Trustee of FRED LOWENSCHUSS, I.R.A., and LAURANCE LOWENSCHUSS, I.R.A.	:	ORDER AMENDING JUDGMENT AND DENYING STAY
Defendants.	:	

Upon the motion (the "Motion') of defendant Laurance Lowenschuss, as current Trustee of the Fred Lowenschuss Associates Pension Plan and on behalf of the Laurance Lowenschuss I.R.A. (the "IRA"), for amendment of judgment pursuant to Bankruptcy Rule 9023 and for stay of judgment pursuant to Bankruptcy Rule 7062; and notice of the Motion having been given to counsel for the Plaintiff, Resorts International, Inc., now known as Sun International North America, Inc. ("RII"), and for good cause shown,

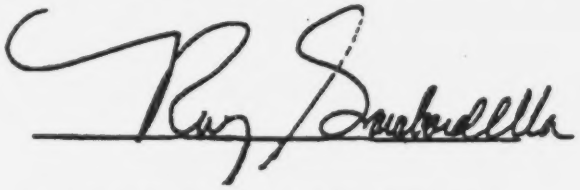
IT IS, on this 25th day of July, 1997,

ORDERED that:

(1) That part of the Motion requesting an amendment of the Court's May 20, 1997 Judgment is granted;

(2) The May 20, 1997 Judgment of this Court shall, be amended to the form annexed hereto as Exhibit A (the "Amended Judgment"); and

(3) That part of enforcement of the judgment Court's June 17, 2.997 order the Motion requesting a stay of and the injunction contained in this is hereby dissolved.



ROSEMARY GAMBARDELLA
UNITED STATES BANKRUPTCY JUDGE

IT IS THE DIRECTION OF THIS COURT THAT THE SUCCESSFUL PARTY SERVE A FILED COPY OF THIS ORDER UPON ALL PARTIES TO THIS ACTION.

Exhibit A

GIBSON, DUNN & CRUTCHER LLP
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North America, Inc.
200 Park Avenue, 47th Floor
New York, NY 10166-1093

DECHERT, PRICE & RHOADS
Co-Counsel to Sun International
North America, Inc.
Princeton Pike Corporate Center
P.O. Box 5218
Princeton, NJ 08543

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW JERSEY

In re:	:	Hon. Rosemary Gambardella
RESORTS INTERNATIONAL, INC.,	:	
RESORTS INTERNATIONAL FINANCING , INC.,	:	Chapter 11
GRIFFIN RESORTS INC., and	:	Case Nos. 89-10119
GRIFFIN RESORTS HOLDING, INC.,	:	89-10120
	:	89-10461
Debtors.:		89-10462

RESORTS INTERNATIONAL, INC.,	:	Adv. Pro.
	:	No. 90-1005
Plaintiff,	:	
	:	
v.	:	
	:	
FRED LOWENSCHUSS, individually and as Trustee of FRED LOWENSCHUSS, I.R.A., and LAURANCE LOWENSCHUSS, I.R.A.	:	AMENDED JUDGMENT
	:	
Defendants.	:	

In accordance with this Court's Opinion dated April 22, 1997, and the Court's 1997 Order Amending Judgment and Denying Stay, and for good cause shown,

IT IS, on this _____ day of _____, 1997,

ORDERED, ADJUDGED and DECREED that:

(1) Judgment is hereby entered in favor of Resorts International, Inc. ("RII') and against Laurance Lowenschuss, Trustee of the Fred Lowenschuss Associates Pension Plan (the 'Pension Plan') on Counts I (Mistake), II (Fraud), and III (Illegal Contract) of the Complaint in the amount of $3,801,600.00.

(2) Judgment is hereby entered in favor of RII and against the Laurance Lowenschuss, I.R.A. (the "IRA") on Counts I (Mistake), II (Fraud), and III (Illegal Contract) of the Complaint in the amount of $3,600.00.

(3) Prejudgment interest is hereby awarded to RII and against the Pension Plan in the amount of $1,649,373.53.

(4) Prejudgment interest is hereby awarded to RII and against the IRA in the amount of $1,561.84.

(5) Punitive damages are hereby awarded to RII and against the Pension Plan in the amount of $249,763.00.

(6) Punitive damages are hereby awarded to RII and against the Pension Plan in the amount of $237.00.

ROSEMARY GAMBARDELLA
UNITED STATES BANKRUPTCY JUDGE

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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW JERSEY

In re:	:	Hon. Rosemary Gambardella
RESORTS INTERNATIONAL, INC.,	:	
RESORTS INTERNATIONAL FINANCING , INC.,	:	Chapter 11
GRIFFIN RESORTS INC., and	:	Case Nos. 89-10119
GRIFFIN RESORTS HOLDING, INC.,	:	89-10120
	:	89-10461
Debtors.:		89-10462

RESORTS INTERNATIONAL, INC.,	:	Adv. Pro.
	:	No. 90-1005
Plaintiff,	:	
	:	
v.	:	
	:	
FRED LOWENSCHUSS, individually and as Trustee of FRED LOWENSCHUSS, I.R.A., and LAURANCE LOWENSCHUSS, I.R.A.	:	JUDGMENT
	:	
Defendants.	:	

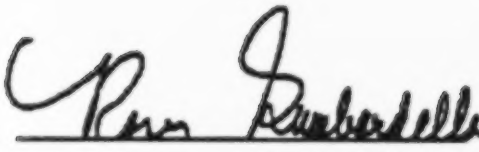
In accordance with this Court's Opinion dated April 22, 1997, and with all prior Opinions and Orders issued by this Court in the above-captioned adversary proceeding,

It is on this 20th day of May, 1997,

ORDERED, ADJUDGED and DECREED that debtor/plaintiff Resorts International, Inc., [1] have judgment against Laurance Lowenschuss, as Trustee of the Fred Lowenschuss Associates Pension Plan, and in his representative capacity on behalf of the Laurance Lowenschuss, I.R.A, in the amount of five million, seven hundred and six thousand, one hundred and thirty-five dollars and fifty-four cents ($5,706,135.54).

---

[1] Sun International North America, Inc., is the successor in interest to Griffin Gaming & Entertainment, Inc., which was formerly known as Resorts International, Inc.



Hon.
Rosemary Gambardella
United States Bankruptcy Judge

IT IS THE DIRECTION OF THIS COURT THAT THE SUCCESSFUL PARTY SERVE A FILED COPY OF THIS ORDER UPON ALL PARTIES TO THIS ACTION.

* This number is comprised of $5,456,195.54 of compensatory damages plus prejudgment interest plus $250,000.00 of punitive damages.

APPENDIX E

The principal statutory provision involved in this case is Section 546 of Title 11 of the United States Code. Section 546(e) provides in relevant part:

§ 546. Limitations on avoiding powers

(a) An action or proceeding under section 544, 545, 547, 548, or 553 of this title may not be commenced after the earlier of —

(1) the later of —

(A) 2 years after the entry of the order for relief; or

(B) 1 year after the appointment or election of the first trustee under section 702, 1104, 1163, 1202, or 1302 of this title if such appointment or such election occurs before the expiration of the period specified in subparagraph (A); or

(2) the time of the case is closed or dismissed.

(b)(1) The rights and powers of a trustee under sections 544, 545, and 549 of this title are subject to any generally applicable law that —

(A) permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of perfection; or

(B) provides for the maintenance or continuation of perfection of an interest in property to be effective against an entity that acquires rights in such property before the date on which action is taken to effect such maintenance or continuation.

(2) If —

(A) a law described in paragraph (1) requires seizure of such property or commencement of an action to accomplish such perfection, or maintenance or continuation of perfection of an interest in property; and

(B) such property has not been seized or such an action has not been commenced before the date of the filing of the petition;

such interest in such property shall be perfected, or perfection of such interest shall be maintained or continued, by giving notice within the time fixed by such law for such seizure or such commencement.

(c) Except as provided in subsection (d) of this section, the rights and powers of a trustee under sections 544(a), 545, 547, and 549 of this title are subject to any statutory or common-law right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, but —

(1) such a seller may not reclaim any such goods unless such seller demands in writing reclamation of such goods —

(A) before 10 days after receipt of such goods by the debtor; or

(B) if such 10-day period expires after the commencement of the case, before 20 days after receipt of such goods by the debtor; and

(2) the court may deny reclamation to a seller with such a right of reclamation that has made such a demand only if the court —

(A) grants the claim of such a seller priority as a claim of a kind specified in section 503(b) of this title; or

(B) secures such claim by a lien.

(d) In the case of a seller who is a producer of grain sold to a grain storage facility, owned or operated by the debtor, in the ordinary course of such seller's business (as such terms are defined in section 557 of this title) or in the case of a United States fisherman who has caught fish sold to a fish processing facility owned or operated by the debtor in the ordinary course of such fisherman's business, the rights and powers of the trustee under sections 544(a), 545, 547, and 549 of this title are subject to any statutory or common law right of such producer or fisherman to reclaim such grain or fish if the debtor has received such grain or fish while insolvent, but —

(1) such producer or fisherman may not reclaim any grain or fish unless such producer or fisherman demands, in writing, reclamation of such grain or fish before ten days after receipt thereof by the debtor; and

(2) the court may deny reclamation to such a producer or fisherman with a right of reclamation that has made such a demand only if the court secures such a claim by a lien.

(e) Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 101, 741, or 761 of this title, or settlement payment, as defined in section

101 or 741 of this title, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency, that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

(f) Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 741 or 761 of this title, or settlement payment, as defined in section 741 of this title, made by or to a repo participant, in connection with a repurchase agreement and that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

(g) Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer under a swap agreement, made by or to a swap participant, in connection with a swap agreement and that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

(h) Notwithstanding the rights and powers of a trustee under sections 544(a), 545, 547, 549, and 553, if the court determines on a motion by the trustee made not later than 120 days after the date of the order for relief in a case under chapter 11 of this title and after notice and a hearing, that a return is in the best interests of the estate, the debtor, with the consent of a creditor, may return goods shipped to the debtor by the creditor before the commencement of the case, and the creditor may offset the purchase price of such goods against any claim of the creditor against the debtor that arose before the commencement of the case. Pub.L. 95-598, Nov. 6, 1978, 92 Stat. 2597; Pub.L. 97-222, § 4, July 27, 1982, 96 Stat. 236; Pub.L. 98-353, Title III, §§ 351, 393, 461, July 10, 1984, 98 Stat. 359, 365, 377; Pub.L. 99-554, Title II, §§ 257(d), 283(l), Oct. 27, 1986, 100 Stat. 3114, 3117; Pub.L. 101-311, Title I, § 103, Title II, § 203, June 25, 1990, 104 Stat. 268,

269; Pub.L. 103-394, Title II, §§ 204(b), 209, 216, 222(a), Title V, § 501(b)(4), October 22, 1994, 108 Stat. 4122, 4125, 4126, 4129, 4142; Pub.L. 105-183, § 3, June 19, 1998, 112 Stat. 517.

FILED
OFFICE OF THE CLERK
SUPREME COURT, U.S.

No. 99-552

IN THE

Supreme Court of the United States

SUN INTERNATIONAL NORTH AMERICA, INC.,

Petitioner,

v.

LAURANCE LOWENSCHUSS, TRUSTEE OF THE FRED LOWENSCHUSS ASSOCIATES PENSION PLAN and LAURANCE LOWENSCHUSS I.R.A.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

Petitioner asks this Court to consider whether the United States Court of Appeals for the Third Circuit erred when it applied 11 U.S.C. § 546(e) of the Bankruptcy Code to bar petitioner's pursuit of a fraudulent transfer action against petitioner's former shareholder arising out of a leveraged buyout transaction. Section 546(e) specifically excerpts from the Code's avoidance powers settlement payments (as defined by section 741(8) of the Bankruptcy Code) made by financial institutions, stockbrokers or securities clearing agencies to their customers. A settlement payment is *any* payment, preliminary or otherwise, commonly used in a securities transaction.The Third Circuit concluded that because the shareholder and petitioner utilized the services of a stockbroker and another financial institution to surrender the shares in exchange for payment, that consideration constituted a settlement payment and section 546(e) barred the petitioner's lawsuit. The Third Circuit held that the plain language of the Bankruptcy Code encompassed the payment at issue and that neither the statute nor the legislative history suggested that Congress intended a more narrow reading of the provision. Thus, the question presented is:

Whether the Third Circuit correctly interpreted section 546(e) to bar a debtor-in-possession or trustee from bringing a constructive fraudulent transfer action to recover a payment made by a financial institution or a stockbroker to a shareholder when the payment is a straightforward settlement transaction.

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OPINIONS BELOW

The opinion of the court of appeals is reported at 181 F.3d 505. Petitioner's Appendix ("Pet. App.") 1a-23a. The opinion of the district court is unreported. Pet. App. 24a-46a. The opinion of the bankruptcy court is also unreported. Pet. App. 47a-105a.

STATEMENT OF JURISDICTION

Respondents do not contest the Court's jurisdiction under 28 U.S.C. § 1254(1). Nonetheless, the respondents contend that should the Court grant the petition, the record will show that the bankruptcy court improperly exercised jurisdiction over the adversary proceeding and the respondents.

STATUTORY PROVISIONS INVOLVED

Although several provisions of the Bankruptcy Code and state law are implicated by this matter, the critical provisions include 11 U.S.C. § 546(e) of the Bankruptcy Code, which provides in relevant part:

> Notwithstanding sections 544, . . . 548(a)(2), and 548(b) of this title, the trustee may not avoid a transfer that is a . . . settlement payment, as defined in section 101 or 741 . . . , made by or to a . . . stockbroker, financial institution, or securities clearing agency. . . .

11 U.S.C. § 546(e). Another important Code provision, section 741, defines a settlement payment to mean:

> a preliminary settlement payment, a partial settlement payment, an interim settlement payments, an interim settlement payment, a settlement payment on account, a final settlement payment on account, a final settlement payment

> or an other similar payment commonly used in the securities trade.

11 U.S.C. § 741(8).

STATEMENT OF THE CASE

In November 1988, Resorts International, Inc. ("RII"), the predecessor in interest to petitioner Sun International North America, Inc., offered all of its Class A common stockholders $36 per share as part of a leveraged buyout transaction ("LBO"). At the time, RII Class A shares were publicly traded on the American Stock Exchange. The Fred Lowenschuss Associates Pension Plan ("Pension Plan"), and the individual retirement accounts ("IRAs") of Laurance and Fred Lowenschuss[1] owned approximately 105,900 Class A shares combined (the "Shares").

RII forwarded a "Notice of Merger of Griffco Acquisition Corp. With and Into Resorts" and an attached Letter of Transmittal to all shareholders. The Notice of Merger provided that shareholders would receive the Merger Price when the Letter of Transmittal and certificates were presented to RII's agent, Chase Manhattan Bank ("Chase"), on or before November 15, 1989. The Letter of Transmittal also permitted appraisal shareholders (of which the Pension Plan was one) to withdraw their appraisal demand at any time in exchange for the merger consideration. RII's forms neither contained a time limit for withdrawal of appraisal requests nor were they amended, superseded or modified. Consistent with the Letter of Transmittal, the Pension Plan decided to withdraw its appraisal demand and tender its stock.

---

1. Fred Lowenschuss and the 100 Shares in his IRA were severed from the case before trial, and he was not a party. Laurance Lowenschuss, as the representative of the Pension Plan and his IRA, is the respondent. For simplicity sake, the Pension Plan and the Laurance Lowenschuss IRA are collectively referred to as the Pension Plan.

The critical facts that bear on the petition relate to the Pension Plan Trustee's exchange of stock for payment in a typical settlement transaction. On July 17, 1989, the Pension Plan Trustee delivered the Shares to its stockbroker, Merrill Lynch, in accordance with RII's proxy materials. Merrill Lynch then forwarded the Shares through the normal brokerage process to Chase, which RII designated as its paying and transfer agent for the Shares. Chase took possession of the Shares. On July 27, 1989, Chase mailed Transfer Journal Sheets dated "07/26/89" to RII identifying the Pension Plan as having surrendered 105,700 shares. Therefore, both RII and Chase (RII's agent) knew that the Shares had been presented for payment.

As with every other surrender share of Class A stock, RII permitted its paying and transfer agent to settle the transaction. On August 1, 1989, RII wired $3,812,313.60 to Chase to pay, *inter alia*, for the Shares. Chase sent a $3,805,200 check payable to Merrill Lynch for the Shares. After receiving the payment, Merrill Lynch, in turn, paid the Pension Plan in full settlement of the surrendered Shares. RII similarly paid *every* tendering shareholder through November 3, 1989.

After the fact, RII determined, for various reasons, that it wanted its money back. RII filed a Complaint on September 26, 1989, in the United States District Court for the Eastern District of Pennsylvania ("Pennsylvania Court") naming Fred Lowenschuss individually and as Trustee of the two IRA's (but not as the Pension Plan Trustee). The record owner of the Shares, the Pension Plan, was not named or referenced in the Complaint. The Complaint sought to reverse the exchange of the Shares, for which RII paid $3.8 million. Fred Lowenschuss filed an Answer and Counterclaims.

After the filing of an involuntary bankruptcy petition on November 12, 1989 against RII in the United States Bankruptcy Court for the District of New Jersey, RII and

several affiliates either consented to or filed for chapter 11 relief.[2] This matter became an adversary proceeding before the bankruptcy court when RII "removed" it *directly* from the Pennsylvania Court, allegedly pursuant to 28 U.S.C. § 1452(a).

Although the case was filed in 1989, it took many years for it to proceed on the merits. RII's primary — and unique — argument was that its *own* proxy materials and conduct were an illegal contract, constituted a mistake or were the result of the Pension Plan Trustee's fraud. It was only after the removal of the action that RII filed an amended complaint that asserted constructive fraudulent transfer claims under N.J.S.A. 25:2-25(b) and 25:2-27(a) and under 11 U.S.C. § 548(a)(1)(B).[3] Thus, while arising in bankruptcy due to RII's chapter 11 filing, the matter primarily was a dispute involving simple, common law claims with the fraudulent transfer claims appended almost as an afterthought. On motions for partial summary judgment in February 1992, the bankruptcy court found the transfer to have been contrary to Delaware appraisal law but left the remedy and remaining mistake, fraud and fraudulent transfer counts for trial.

Having initially omitted the record owner of the Shares, RII moved to have the Pension Plan deemed a party, and by a June 13, 1995 Order, the Pension Plan was declared to have been a party from the case's inception in disregard of

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2. The Bankruptcy Court ultimately confirmed RII's Plan of Reorganization in 1990. *In re Resorts International, Inc.*, 145 B.R. 412 (Bankr. D.N.J. 1990). RII subsequently filed a second bankruptcy in the United States Bankruptcy Court for the District of Delaware in 1994. RII confirmed a second Plan of Reorganization that same year.

3. RII also asserted an actual fraudulent transfer claim under state and bankruptcy law. However, recognizing that it could not meet the requisite elements of this claim, RII abandoned it after trial.

prior contrary findings.[4] The bankruptcy court then severed the claims against Fred Lowenschuss individually from those against the Pension Plan and Laurance Lowenschuss's IRA and proceeded solely against the Pension Plan and IRA. At trial in November 1995, RII sought rescission and restitution on the grounds of mistake, fraud and illegal contract and to avoid the payment as a fraudulent transfer.

On April 22, 1997, the court issued an opinion, finding for RII as to mistake, fraud and illegal contract, dismissing the fraudulent transfer claims as barred by operation of section 546(e) of the Bankruptcy Code, and awarding $3,805,200, plus punitive damages of $250,000 and prejudgment interest against the Pension Plan. A judgment was entered on May 20, 1997. The court thereafter eliminated joint liability, limiting the judgment against the IRA to $3,600, plus punitive damages of $237 and interest of $1,561.84, and the Pension Plan to $3,801,600, plus punitive damages of $249,763 and interest of $1,649,373.53.

In an unreported opinion, the United States District Court for the District of New Jersey reversed the judgment on the mistake, fraud and illegal contract claims. Pet. App. 45a-46a. The district judge held that RII failed to prove even the most basic elements of the common law. Pet. App. 29a-43a n.7. The district court affirmed without substantial discussion of the bankruptcy court's dismissal of the fraudulent transfer claims.

The Third Circuit agreed with the district court that RII's common law claims had no merit. Pet. App. 6a-15a. The critical ruling for purposes of RII's petition was the circuit court's holding that section 546(e) of the Bankruptcy Code barred RII constructive fraudulent transfer claims against the

---

4. The improper exercise of jurisdiction over the Pension Plan is also grounds for dismissal of the underlying adversary proceeding with respect to the Pension Plan.

Pension Plan. In particular, the Third Circuit found that the Pension Plan's use of Merrill Lynch as its stockbroker and RII's use of Chase to exchange the Shares for the settlement payment barred any suit against the Pension Plan. Pet. App. 22a. The panel found that RII's payment was a settlement payment as defined by the Code, given the broad language used by Congress in defining "settlement payment." Pet. App. 18a. The circuit court found *no* basis to limit the definition of "settlement payment" so as to exclude an LBO transaction.[5] Pet. App. 20a. The court also refused to ignore the statute as written by Congress: to bar all attempts to avoid payments by a stockbroker or financial institution to a shareholder using constructive fraudulent transfer causes of action. Pet. App. 20a-21a. The court concluded that there was no basis to ignore the plain language of the statute that would leave former public shareholders outside of the protections of section 546(e). Pet. App. 21a.

REASONS FOR DENYING THE WRIT

THE FRAUDULENT TRANSFER LAWS WERE NEVER APPLICABLE TO THE TRANSACTION BETWEEN RII AND THE PENSION PLAN

This Court may issue a Writ of Certiorari to consider matters where the petitioner has demonstrated that two or more circuit court rulings are in conflict over a question of national importance. Sup. Ct. R. 10(a). RII's petition suggests that a circuit conflict exists. However, the alleged conflict, if one exists at all, is simply not of the importance or nature to warrant review by this Court. Even if the Court were to

5. Indeed, no court has ever pointed to a specific passage of legislative history that shows Congress intended to *exclude* LBO transactions from the term "settlement payment". RII also fails to identify any specific legislative history that supports such an interpretation; rather it simply states that at the time section 546(e) was enacted, no one "suggested" that an LBO was the type of transaction that should come within the statute's reach.

ultimately consider the question, it is unclear whether it would reach the merits, as there are serious jurisdictional flaws in RII's underlying case discussed more fully in section C, *infra*. Moreover, given that there is no real conflict and that the Third Circuit's ruling is the correct decision, there is no need for review on the merits at this time. The question raised by RII is simply not one of great importance to the future interpretation of the Bankruptcy Code, and the Court should decline to issue a Writ of Certiorari.

A. While Section 546(e) May Be An Important Statute, The Issue For Which RII Seeks Review Is Not One Of National Importance.

It is not disputed that because of the sometimes conflicting goals of the federal securities laws and the Bankruptcy Code, Congress chose to exempt certain securities transactions from the trustee avoidance powers of the Bankruptcy Code. Indeed, in section 546(e) of the Code, Congress decided to exempt any payment made by or to a stockbroker or other financial institution in exchange for the tender of securities from the application of constructive fraudulent transfer law.

RII's petition focuses on whether a particular type of transaction, a leveraged buyout, qualifies as a securities transaction within the meaning of section 546(e). RII argues that the Third Circuit was mistaken in applying section 546(e) to an LBO for two reasons. First, RII asserts that because of the nature of an LBO transaction, the brokerage and financial institutions in the settlement chain are not "transferees" but mere conduits, thereby permitting the courts to ignore such entities' presence in the transaction. Second, RII argues that LBO payments received by a shareholder from an entity in the securities clearance chain are not "settlement payments" as defined by the Bankruptcy Code. In seeking the writ, RII argues that answering these questions is an issue of critical national importance. This is simply not the case.

What RII seeks is to have this Court consider is an issue that has its roots in a financial practice that was a product of the 1980s' merge and acquisition mania. While still occurring today, LBOs are less frequent and take a substantially different form from the 1980s version. As a result, the issues are not likely to be important in the bankruptcy context in the future.

By definition, a leveraged buyout involves the takeover of a company using borrowed funds. *See* DICTIONARY OF FIN. & INV. TERMS 297-98 (John Downes & Jordan Elliot Goodman eds., 4th Ed. 1995). Often, the target company's assets serve as the collateral for the loans used to finance the purchase. *Id.* The acquiring company then repays the loans from the target entity's profits or by selling the target's assets. *Id.* During the 1980s, many leveraged buyouts were financed through the issuance of "junk bonds". *Id.* at 284. Junk bonds are corporate debt instruments that involve greater than usual risk as an investment and pay a relatively high rate of interest. *Id.* Such bonds are typically issued by a company lacking an established earnings history or having a questionable credit history. *Id.*

In the past, when companies were acquired through LBOs, the target's debt burden was often too large for the target to handle. This fact resulted in a rash of corporate bankruptcies in the late 1980s and early 1990s, as well as portfolios of valueless junk bonds. *See* John Greenwald, *LBOs: Let's Bail Out if the Economy Goes South, Debt-Heavy Buyouts Could Go Under*, Time, Aug. 14, 1989, at 50. Many otherwise financial sound companies were the victims of LBO mania. *See, e.g., id.* RII was one target company that could not meet its debt burden and which ultimately was forced to seek chapter 11 protection twice.

It is estimated that during the 1980s, at least $500 billion in LBO transactions took place. During the 1990s, companies transacted just a fraction of the number and amount of LBOs,

while at the same time, total equity market capitalization has soared to unprecedented levels.[6] The financing of LBOs has also changed radically since 1990. The overwhelming majority of recent LBOs were financed in a manner other than through the junk bond market. *See* Merrill Goozner, *Investors Flocking to Junk Bonds, But Risks Are Not for Everyone*, Dallas Morn. News, June 15, 1997. Thus, post-LBO companies of today appear financially more sound than their 1980's counterpart.

Of particular interest is the fact that the impact of the leveraged buyout to the bankruptcy process has all-but-disappeared. Even the most recent circuit cases, the one

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6. Considering the relative value of publicly traded companies in 1980s as opposed to the 1990s further reinforces the loss of importance of LBOs in today's business world. In 1990, total market capitalization of all publicly traded companies on the New York Stock Exchange was estimated to be $2.6 trillion. William E. Sheeline and Alan Deutschman, *Money & Markets: Who Needs The Stock Exchange? We All Do, Because It Is The Central Marketplace That Sets The Prices For Investors. But America's No. 1 Exchange Is Threatened With Unplanned Obsolescene*, Fortune, Aug. 19, 1990. $500 billion in LBO transactions during the 1980's constituted a not insubstantial percentage of market capitalization. Since 1990, the total market capitalization of the New York Stock Exchange has more than quadrupled, exceeding $11.3 trillion, while total market capitalization of all United States exchanges exceeds $28 trillion. *Hearings on Proposals Certified to Save Social Security Before the House Committee on Ways and Means*, 106th Cong., 1st Sess. (1999) (statement of the Honorable Marshall "Mark" Sanford, M.C., South Carolina) (available on the internet at www.house.gov/ways_means/hearin.htm). By comparison, from 1996 to 1998, the three most-active LBO years since 1989, only about $84 billion in LBO transactions took place. *See Buyout Deals Reach $41 Billion*, UPI, Jan. 1, 1999; Matthew Schifrin, *LBO Madness*, Forbes, Mar. 9, 1998, p. 128; Tom Petruno, *Buyouts Are Back. LBOs, One Symbol of Greed in '80s, Are Giving Stock Market a Boost*, Minneapolis Star Tribune, Dec. 12, 1996, p. 01D. As a percentage of market capitalization, LBOs are simply not significant.

before this Court now and *Munford v. Valuation Research Corp. (In re Munford, Inc.)*, 98 F.3d 604 (11th Cir. 1996), *cert. denied, sub nom. Dimensions Group, Inc. v. Munford, Inc.*, __ U.S. __, 118 S. Ct. 739, *and Munford v. Munford, Inc.*, __ U.S. __, 118 S. Ct. 739 (1998), were the result of LBO transactions that occurred nearly ten years ago. None of the lower court cases cited in RII's petition appears to involve an LBO that took place more recently than 1991. And, given today's business climate, the unwinding of LBO transactions is not likely to be an important feature of future bankruptcy cases.

After the failure of many LBOs, it is not surprising that creditors, trustees and debtors-in-possessions turned to the fraudulent transfer laws to attempt to recover some of their losses. In cases that did not involve the securities process, section 546(e) was no bar to recovery under a fraudulent transfer theory. However, when lawsuits started to include shareholders of publicly traded companies, section 546(e) of the Bankruptcy Code on its face seemed to bar fraudulent transfer actions. *See, e.g., Kaiser Steel Corp. v. Pearl Brewing Co. (In re Kaiser Steel Corp.)*, 952 F.2d 1230, 1240 (10th Cir. 1991). Several courts have attempted to circumvent 546(e), ostensibly relying upon what Congress allegedly intended when enacting section 546(e). As discussed *infra*, the rationale put forth by these courts was unnecessary as the facts surrounding the transactions clearly put them outside of the scope of the securities clearance system. Thus, it is difficult to image how such a ruling by the Court in this proceeding will provide more guidance than the Third Circuit has already provided.

B. The Record Below Will Not Support A Ruling That Will Resolve The Alleged Conflict Between The Circuits.

The Third Circuit concluded that the Pension Plan's utilization of Merrill Lynch as its stockbroker and RII's use

of Chase as its paying and transfer agent insulated the LBO transaction from the reach of the avoidance powers. Pet. App. 22a. In reaching that determination, the panel noted that it was not in agreement with the reasoning of the majority in the Eleventh Circuit case in *In re Munford*, at least as to whether the transfer was made to or by a protected entity. Pet. App. 21. The Third Circuit also noted that it did not agree with several district court cases which had ruled that receiving consideration in exchange for delivery of shares in an LBO was not a "settlement payment" as defined by the Bankruptcy Code. Pet. App. 19a. However, regardless of the Third Circuit's disagreement with the reasoning of those cases, there is neither a true circuit conflict nor a meaningful conflict with any of the district court rulings.

It is important to note a critical factual distinction between the transaction in *Munford* and the one in this case. In *Munford*, the debtor's shareholders delivered their shares directly to a bank that held the debtor's funds in trust to pay for the shares. 98 F.3d at 610. According to the circuit panel, the bank did not obtain a "beneficial interest in the funds" as it was not serving as an entity in the securities clearance chain.[7] *Id.* Consequently, the Eleventh Circuit held that the bank was merely a conduit for the transfer of the funds to the former shareholders. *Id.* The *Munford* Court effectively collapsed the transaction so that it involved a transfer of stock directly to the target corporation in exchange for payments directly to the shareholders.

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7. The district court found that the bank was holding the funds deposited by the debtor as trust funds and was effectively nothing more than an escrow agent. *See Munford, Inc. v. Munford*, 188 B.R. 860, 863 (N.D. Ga. 1996), *aff'd in part, rev'd in part sub nom. Munford v. Valuation Research Corp. (In re Munford, Inc.)*, 98 F.3d 604 (11th Cir. 1996), *cert. denied, sub nom. Dimensions Group, Inc. v. Munford, Inc.*, __ U.S. __, 118 S. Ct 739, *and Munford v. Munford, Inc.*, __ U.S. __, 118 S. Ct. 739 (1998). There is no such finding in this case.

In this case, Chase did not hold the payment as a trust fund or merely serve as an escrow agent. Rather, RII admitted Chase served as both its paying and transfer agent. The common understanding is that paying agents are responsible for paying dividends or making other distributions on behalf of the corporation to shareholders. DICTIONARY OF FIN & INV. TERMS at 410. Transfer agents are responsible for maintaining shareholder records and canceling and issuing shares on behalf of the corporation. *Id.* at 615. Thus, it appears that Chase was operating in the context of the securities settlement process when it accepted delivery of the Shares and forwarded the funds to Merrill Lynch that ultimately were used to pay the Pension Plan.

Second, there was an additional entity in this transaction that was not present in *Munford*. The Pension Plan employed Merrill Lynch, its stockbroker, to effectuate the transaction. A " 'stockbroker' means [a] person . . . with respect to which there is a customer, as defined in section 741(2) of this title. . . ." 11 U.S.C. § 101(53A)(A). A "customer" is defined, in relevant part, as

> (A) entity with whom a person deals as principal or agent and that has a claim against such person on account of a security received, acquired, or held by such person in the ordinary course of such person's business as a stockbroker, from or for the securities account or accounts of such entity — . . .
>
> (ii) with a view to sale; . . .
>
> (B) entity that has a claim against a person arising out of —
>
> (i) a sale or conversion of a security received, acquired, or held as specified in subparagraph (A) of this paragraph; or

> (ii) a deposit of cash, a security, or other property with such person for the purpose of purchasing or selling a security;

11 U.S.C. § 741(2). According to the Sixth Circuit, "the legislative history [of section 741(2)] suggests that a customer includes 'anybody that interacts with the [alleged stockbroker] in a capacity that concerns security transactions.' " *WesBanco Bank Barnesville v. Rafoth (In re Baker & Getty Fin. Svcs., Inc.)*, 106 F.3d 1255, 1260 (6th Cir.), *cert. denied*, 118 S. Ct. 65, 139 L. Ed. 2d 27 (1997), *quoting* H.R. Rep. No. 95-595 (1977), *reprinted in* 1978 U.S. Code & Cong. Ann. News. 6223-27. The Sixth Circuit also noted that

> the definition of customer turns on the *purpose of the* [investor] rather than the status or intent of the [stockbroker]. An investor qualifies as a customer when the investor *deposits money or securities* with the [stockbroker] with the expectation that the [stockbroker] purchase stock or trade securities.

Id. (emphasis supplied). The *WesBanco* panel also rejected the contention that because the entity may have not been executing a securities trade on behalf of the customer in a particular circumstance, the entity lost its status as a stockbroker for that particular transaction. *See id.* at 1262 (unlicensed broker that converted customer deposit for its own purposes rather than to conduct a trade remained a stockbroker as it had engaged in trades on behalf of other customers in the past). Therefore, if an entity is a stockholder, the Code treats all transfers of property, stock or cash to have taken place in a stockbroker-customer relationship.

The Pension Plan was a "customer" within the meaning of the Bankruptcy Code. It delivered securities or "property"

to Merrill Lynch in the anticipation that Merrill Lynch would complete the stock purchase transaction. Since it cannot seriously be disputed that Merrill Lynch was a stockbroker at the time of the transaction as defined by the Bankruptcy Code,[8] it follows that section 546(e) has specifically exempted payments *by or to* Merrill Lynch from the reach of the avoidance powers. This relationship did not exist in *Munford*, strongly suggesting that the reasoning of *Munford* is inapplicable here.[9]

While RII acknowledges that there is no circuit-level conflict as to the definition of "settlement payment," it seeks to elevate supposed conflicts at the district court level to ones of substantial importance. However, as with the *Munford* case, the record relied upon by the Third Circuit to determine that the payment here constituted a settlement payment

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8. Even if the Pension Plan were not a customer, Merrill Lynch has hundreds of thousands of customers who utilize Merrill Lynch as a stockbroker. Thus, for purposes of section 546(e), Merrill Lynch qualifies as a stockbroker. *See WesBanco*, 106 F.3d at 1262.

9. RII attempts to elevate two circuit decisions addressing the "mere conduit" theory under 11 U.S.C. § 550, *Christy v. Alexander & Alexander of New York Inc. (In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey)*, 130 F.3d 52, 59 (2d Cir. 1997), and *Bonded Fin. Svcs. v. European Am. Bank*, 838 F.2d 890, 893 (7th Cir. 1988), as cases in conflict with the Third Circuit's decision here. Neither case had anything to with the application of section 546(e) or LBO transactions. More importantly, the more specific Code section, section 546(e), operates without reference to the requirements of the more general section 550. Section 546(e) simply exempts from the reach of the trustee or debtor any person receiving payments from one of the specified entities. There is no requirement that the specified entity also be considered a transferee for purposes of fraudulent transfer law. Rules of statutory construction therefore run counter to RII's argument. *Simpson v. United States*, 435 U.S. 6, 7 (1978) ("precedence should be given to the terms of the more specific statute where a general statute and a specific statute speak to the same concern . . .").

differs sharply from the facts in the lower court cases cited by RII. This factual difference naturally limits the importance of a ruling on the merits.

For example, in *Zahn v. Yucaipa Cap. Fund*, 218 B.R. 656, 676 (D.R.I. 1998), there was simply *no* exchange of stock for cash through any of the entities listed in section 546(e). In fact, the stock in *Zahn* was even not publicly traded, and, thus did not implicate the securities settlement system in any way.[10] *Id.* Similarly, in *Jewel Recovery, L.P. v. Gordon*, 196 B.R. 348, 353-54 (N.D. Tex. 1996), *Brandt v. Hicks, Muse & Co., Inc. (In re Healthco Internat'l, Inc.)*, 195 B.R. 971, 981 (Bankr. D. Mass. 1996) and *KSC Recovery, Inc. v. First Boston Corp. (In re Kaiser Merger Litigation)*, 168 B.R. 991, (D. Colo. 1994), each court held section 546(e) to be inapplicable because the shareholders were not paid by any one of the listed entities in section 546(e), and in the case of *KCS Recovery*, the alleged payments were found to have predated the LBO and to have been made in return for proxies and options for new shares. Factually, each case differs radically from this case below and, by definition, fall outside the scope of section 546(e).

In *Wieboldt Stores, Inc. v. Schottenstein*, 131 B.R. 655 (N.D. Ill. 1991), a district court held that payments of LBO consideration were not settlement payments. The case is again distinguishable because of important factual differences. First, as in *Munford*, the financial institution in question did not appear to be functioning as anything more than an escrow agent for the acquired entity; thus, the entity's role and the roles of Chase and Merrill Lynch here differed

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10. RII suggests in footnote 15 of the petition that the *Zahn* Court's refusal to apply section 546(e) to an alleged private stock sale intermediary that was not specifically named in the statute was the elevation of substance ovér form. Respondent respectfully suggests that a more plausible basis for the *Zahn* Court's decision is that was merely applying the statute as written.

substantially. Second, the district court ruled that although the legislative history was not dispositive and the statute appeared facially applicable, it was free to ignore the statute's language because in that particular transaction, the court was unable to perceive of any risk to the clearance and settlement chain. *Id.* at 665-66. Thus, the *Wieboldt* case is a classic example of legislation by judicial fiat. In fact, all the circuits considering section 546(e) have rejected or sharply criticized the reasoning of *Wieboldt*, one noting that:

> On its face, the statute is clear. The statue exempts payments made "by or to" a stockbroker, financial institution, or clearing agency. Again, unless there is some reason to believe the clear application is abused and otherwise unreasonable we leave our inquiry at that.

In re Kaiser Steel, 952 F.2d at 1240 (emphasis supplied). *See In re Munford, Inc.*, 98 F.3d at 610 n.4 ("We reject the reasoning of *Wieboldt[,]* finding that even granting trustees avoidance powers under limited circumstances in the LBO context has the potential to lessen confidence in the commodity market as a whole.").

C. The Trial Court Lacked Jurisdiction Because Of The Improper Removal From The Pennsylvania Court.

There is a serious jurisdictional flaw that would likely prevent the Court from reaching the merits upon the granting of a writ.[11] After the initiation of RII's bankruptcy, RII removed this case directly from the Pennsylvania Court under 28 U.S.C. § 1452 to the bankruptcy court. In upholding the "direct removal," the lower courts rejected case law that held

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11. In addition, respondents believe that the bankruptcy court's order that permitted RII to "amend the caption" to add the Pension Plan Trustee as a party was also error. Reversal of that order would also deprive the bankruptcy court of jurisdiction.

that a direct removal is in contravention of the removal statute and 28 U.S.C. § 157(a).

The majority of cases that have addressed "direct removal" have rejected it and found it to be a void act. *See Cornell & Co., Inc. v. Southeastern Pa. Transp. Auth. (In re Cornell & Co., Inc.)*, 203 B.R. 585 (Bankr. E.D. Pa. 1997); *Thomas Steel Corp. v. Bethlehem Rebar Indus., Inc.*, 101 B.R. 16 (Bankr. N.D. Ill. 1989). While some decisions like *Cornell* involved a transfer between courts in the same district, other cases make it clear that section 1452 does not allow a transfer from *any* court directly to the bankruptcy court. *Furr v. Barnett Bank of Marion Cty. (In re S & K Air Power of Fla., Inc.)*, 166 B.R. 193 (Bankr. S.D. Fla. 1994); *Centrust Sav. Bank v. Love*, 131 B.R. 64, 66-67 (S.D. Tex. 1991). *But see In re Princess Louise Corp.*, 77 B.R. 766 (Bankr. C.D. Cal. 1987) (allowing direct removal to a bankruptcy court).

In *Centrust*, the court identified the jurisdictional flaw in direct removal, noting that in enacting section 1452, Congress expressly limited removal to "the district court." *Id.* at 66. The court then emphasized that:

> [B]ankruptcy courts receive cases by referral, never by removal. Like other case management orders, the referral is left to the discretion of the district court. . . . Proper procedure to have the case reach the bankruptcy court is to petition the district court for an order of reference.

Id. The court also stressed that "[s]ection 1452 is part of *Chapter 89: Removal of Cases from State Courts*. By its terms, it does not provide for removal from federal district court." *Id.* at 67.

Although Third Circuit summarily dismissed the jurisdictional argument (Pet. App. 22a n.12), the majority of

cases hold that any transfer between a federal district court to a bankruptcy court in another district must occur at the district court level. The proper step would then be to refer the matter under section 157(a), the only permissible basis for a bankruptcy court to exercise jurisdiction.[12] Because improper removal results in a void act, should this Court grant the writ, it would likely dismiss the case as having been improperly removed by RII.

D. Even If The Court Were To Grant The Petition, The Third Circuit's Decision Is The Proper One And Would Be Affirmed.

Section 546 expressly limits a debtor's right to pursue fraudulent transfers, preferences or other avoidance actions that involve "settlement payments" by or to a stockbroker or other institution. 11 U.S.C. § 546(e). Section 741 defines a settlement payment as broadly as possible and specifically notes that it any "other similar payment commonly used in the securities trade." 11 U.S.C. § 741(8). *See also* 11 U.S.C. § 101(51A) (similar definition as to forward contracts).

This Court has consistently admonished lower courts to literally apply federal statutes, except in those rare cases where the language will produce an absurd result or one that is clearly at odds with Congress's intent in drafting the statute. *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989). One of the basic premises put forth by this Court is that where Congress attaches no qualifiers or modifiers to a phrase, courts should not place limitations on the statute's scope. *See Lewis v. United States*, 455 U.S. 55, 60 (1980). Thus, the addition by judicial fiat of language to an unambiguous statute cannot be considered a natural reading of the statute.

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12. Notably, RII did not repeat its error when seeking to transfer a later proceeding between districts and *then* moving to have it referred pursuant to 28 U.S.C. § 157. *Laurance Lowenschuss v. Resorts International, Inc.*, 194 B.R. 339, 343, 350 (D.N.J. 1996).

The Third Circuit has commented extensively on the application of section 546(e), first, in *Bevill, Bresler & Schulmar Asset Mgmt. Corp. v. Spencer Sav. & Loan Ass'n*, 878 F.2d 742, 747 (3d Cir. 1989), and now in this case. Although the *Bevill* case involved section 546(f) in a "repo" transaction, the panel's ruling relied on the legislative history of section 546(e), upon which subsection (f) was modeled. In examining section 546(e), the *Bevill* Court concluded that the important policies behind the avoidance powers were "on a collision course" with the important policies of the securities laws. *Id.* at 751. According to the *Bevill* Court, Congress decided to remedy the conflict by:

> removf[ing] the right . . . to avoid transactions under certain circumstances. Thus, . . . the 1982 amendments were designed in cases of securities in general to "ensure that the avoiding powers of a trustee are not construed to permit margin or settlement payments to be set aside except in cases of fraud [by the purchaser]."

Id. at 751, *quoting* H. Rep. No. 97-420, 97th Cong., 2nd Sess. 1 (1982), U.S. Code Cong. & Admin. News 1982, p. 583. In addition to Congress's stated intent to protect the commodities and securities market by preventing the insolvency of a securities firm from spreading to other firms, the Third Circuit noted an additional and more expansive legislative intent in enacting section 546(e), emphasizing that:

> Congress wanted to go further to protect margin payments and settlement payments made by and to *participants* in the securities market *generally*. Accordingly, it add a new subsection to . . . § 546. . . .

Id. at 747 (emphasis supplied). Thus, the Third Circuit concluded that the exemption of settlement payments from

avoidance actions contained in section 546(e) was "extremely broad." *Id.* at 751.

Exhibiting consistency, the Third Circuit maintained its broad and literal interpretation of section 546(e) in this case, stating that,

> [i]n the securities industry, a settlement payment is generally the transfer of cash or securities made to complete a securities transaction. . . . Here, the securities passed from Lowenschuss's broker, Merrill Lynch, to the transfer bank, Chase Manhattan. Resorts wired funds to Chase which Chase then forwarded them to Merrill Lynch who paid Lowenschuss. Although no clearing agency was involved in this transfer, two financial institutions — Merrill Lynch and Chase — were. Under a literal reading of section 546, therefore, this was a settlement payment "made by . . . a financial institution."

Pet. App. 19a (internal citations omitted). According to the Third Circuit, the broad interpretation compels a conclusion that all securities transactions are to be included in the definition of settlement payments. Neither the *Bevill* panel nor the panel below noted any contrary intent expressed in the legislative history.

The Tenth Circuit has also broadly interpreted section 546(e) to include LBO consideration as settlement payments. *Kaiser Steel Corp. v. Pearl Brewing Co.*, 952 F.2d 1230, 1239-40 (10th Cir. 1991), *cert. denied*, 505 U.S. 1213 (1992). Thus, a beneficial shareholder that received a payment from its broker in exchange for shares is protected from section 544 and 548(1)(B) actions. *Id.* at 1240-41. Indeed, the transaction in *Kaiser Steel* is almost identical to the transaction in this case. In *Kaiser Steel*, the LBO agreement provided that Kaiser would be purchased for $162 million

by outside investors through a merger with a new entity owned entirely by the investors. *Id.* at 1235. Upon the merger, all common stock shareholders received the right to a $22 per share payment and shares of preferred stock, which the Tenth Circuit identified as the "LBO consideration." *Id.* After the merger, shareholders tendered shares to Kaiser's disbursing agent through brokers and intermediaries in return for the LBO consideration. *Id.* at 1235-36.

After Kaiser Steel filed Chapter 11, a trustee sought to avoid the payments, arguing that section 546(e) did not apply to LBO's. *Id.* at 1238-39. The court refused to narrow the scope of section 546 and rejected the argument:

> The former . . . shareholders effectively sold their interests to new investors for money and a continuing stake in the new entity as preferred shareholders. In settlement, the . . . shareholders tendered their shares and received payment. These payments were "settlement payments. . . ."
>
> [Such] investors[s] will not be forced to disgorge the payments several years later.

Id. at 1239-40. The court also rejected the argument that payments by brokers to equity securities holders were not covered. The court held that the "clear application" includes "settlement payments *by* or to" a stockbroker in any context and would, therefore, include payments by a broker to a shareholder. *Id.* at 1240 (emphasis supplied). There is no question that the merger consideration was a settlement payment first made by Chase, a protected entity, to Merrill Lynch, a protected entity, and then to the Pension Plan by Merrill Lynch.[13]

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13. RII would not be successful even if this Court were to consider the merits. The record evidence uniformly points to a per share value of at least $36 on the merger date and also demonstrates (Cont'd)

Courts that graft additional requirements onto the statute are not following the plain language rule. As noted by the Third Circuit, the Bankruptcy Code does not require that a settlement payment be one that involves a transfer of the beneficial interest in a stock. Pet. App. 21a. Courts that impose such a requirement are therefore acting in contravention of the plain language of the statute. Similarly, RII's argument that the *Munford* case compels one to consider first whether an entity satisfies the definition of "transferee" under 11 U.S.C. § 550 before applying section 546(e), is contrary to the express language of the Code and the rules of statutory construction, that is, the more specific statute takes precedence over the more general. *Simpson v. United States*, 435 U.S. 6, 7 (1978). There is no requirement that the listed entity in section 546(e) must be a transferee for purposes of fraudulent transfer law.

RII's suggestion that the Third and Tenth Circuits ignored the legislative intent of section 546(e) is similarly insupportable. In fact, at least one district court has admitted that the legislative history is in no way dispositive. *Wieboldt Stores*, 131 B.R. at 665. Based upon its review of the legislative history of section 546 in *Bevill*, the Third Circuit determined that Congress intended to protect *all* participants in the securities markets generally from being forced to disgorge funds in bankruptcy cases. No one, including RII, has pointed to specific legislative history that warrants a determination to the contrary. At best, RII can only suggest that such an intent was not contemplated. However, if Congress had intended to limit the bar of section 546(e), it certainly knew how. For example, Congress could have simply modified the language of the statute to make it

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(Cont'd)
that the Pension Plan waived its rights of appraisal in exchange for the merger consideration. Both facts would constitute an exchange of reasonably equivalent value, which defeats RII's fraudulent transfer argument.

inapplicable to payments to shareholders, as it did when it permitted trustee's and debtors-in-possession to pursue settlement payments that constitute actual fraudulent transfers.

CONCLUSION

A Writ of Certiorari should not be granted because the issue is not one of national legal import. The decline in popularity and the financial evolution of the leveraged buyout suggest that it will not have a meaningful impact in the bankruptcy context in the coming years. Moreover, the ruling by the Third Circuit is factually unique and therefore a decision on the merits is not likely to resolve the alleged conflicts. There is also a serious jurisdictional question that would likely prevent the Court from considering the merits in any event. Finally, the Third Circuit's ruling is simply the correct decision, and there is no need for review at this time. In sum, the petition does not raise an issue of great importance to the future interpretation of the Bankruptcy Code. Accordingly, this Court should decline to issue a Writ of Certiorari.

Respectfully submitted,

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Supreme Court, U.S.
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No. 99-552

IN THE

Supreme Court of the United States

SUN INTERNATIONAL NORTH AMERICA, INC.,
Petitioner,

v.

FRED LOWENSCHUSS, individually and as Trustee of FRED LOWENSCHUSS, I.R.A., LAURANCE LOWENSCHUSS, I.R.A., and FRED LOWENSCHUSS ASSOCIATES PENSION PLAN,
Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

This case presents a clear, acknowledged inter-circuit conflict over the statutory interpretation of important provisions of the Bankruptcy Code ("*Code*"). In the end, respondents are forced to concede that this case presents such a conflict, *see* Opp. at 11, but they try to hide from that conflict by conjuring purported factual distinctions and claiming that the *Code* provisions at issue are somehow not sufficiently important to warrant this Court's resolution of the conflict. Respondents' contrived efforts to manufacture factual complexity cannot overcome the fact that their proffered distinctions were never so much as suggested by the Third Circuit, which instead forthrightly acknowledged the circuit conflict that its decision in this case created. *See* Petition at 19-20. Because the Third Circuit's decision conflicts with the Eleventh Circuit's decision in *Munford v. Valuation Research Corp.*, 98 F.3d 604 (11th Cir. 1996), and is inconsistent with the text and structure of the *Code*, plenary review clearly is warranted.

1. Respondents assert that there is a "critical factual distinction" between the transfer in *Munford* and the one in this case because a second protected entity, the stockbroker Merrill Lynch, was also an intermediary in the transfer from Resorts to respondents. Opp. at 11-14.[1] The Third Circuit, however, never adverted to that "critical" distinction, much

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[1] Respondents' attempt to distinguish between the financial institution in this case, Chase, and the financial institution in *Munford* is frivolous. Opp. at 11-12. Both here and in *Munford* the financial institution was an intermediary in the transfer of funds and shares between the debtor and the shareholders.

less relied on it to reject petitioner's arguments here. Instead, the Third Circuit recognized that its reasoning cannot be reconciled with the analysis adopted by the *Munford* majority, and it expressly stated that it was more persuaded by the dissent in that case. Pet. App. at 21a. The Third Circuit, in fact, essentially rejected the position respondents now advocate, finding that this case involved "similar payments" as were made in *Munford*. *Id.* at 20a. Respondents' manufactured "factual distinctions" are irrelevant to the conflict between the circuits that petitioner presents to the Court for resolution in this case.[2]

Contrary to respondents' suggestion, this case does not involve a matter of textual interpretation on the one hand and policy arguments on the other. As the petition made clear, the Third and Eleventh Circuits are sharply divided over two alternative textual readings of the *Code*. *See* Petition at 17-21. The Eleventh Circuit was confronted in *Munford* with the same question presented to the Third Circuit here: whether section 546(e) provides an exception to *any* transfer in which a protected entity happens to be involved as an intermediary; or whether section 546(e) applies *only* to transfers in which a protected entity is directly involved either as the debtor or as the transferee. The two circuits

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[2] Respondents' efforts to explain away the disarray among district courts are similarly without merit. *See* Opp. at 15-16. Those courts, like the circuit courts, have been confronted with determining whether the section 546(e) exception applies to transfers from a bankrupt to a transferee where the transferee is not a protected entity under section 546(e).

reached conflicting conclusions based upon their analysis of the text and structure of the statute.

The Eleventh Circuit's decision in *Munford*, unlike the Third Circuit in this case, observes a fundamental principle of statutory interpretation: that "individual sections of a single statute should be construed together." *Erlenbaugh v. United States*, 409 U.S. 239, 244 (1972). The Eleventh Circuit recognized that, because section 546(e) is an *exception* to a class of avoidable transfers of a debtor's interest, it must be read in the context of the provisions of the *Code* that generally govern an avoided transfer—precisely the type of "holistic" approach to interpreting the *Code* that this Court mandated in *United Savings Ass'n v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371 (1988). *See* Petition at 18-20 & n.12. The general rules regarding avoided transfers are found in *Code* sections 544, 545, 547, 548(a)(1)(B), 548(b), and 550. *See Code* § 546(e). Section 550 is particularly significant because it governs the recovery of property that was the subject of a transfer that the trustee may avoid under sections 544 and 548(a)(1)(B), among others. *Id.* § 550.[3] Of course, if the property is not recoverable from a party in the first place, then there is little point in providing an exception (such as the section 546(e) exception at issue here) to shield that property from the

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[3] Respondents' carefully worded assertion that section 546(e) "operates without reference to the requirements of the more general section 550," Opp. at 14 n.9, is misleading. Although not specifically cited in 546(e), section 550 is an essential part of the *Code* provisions to which section 546(e) provides an exception.

trustee's avoidance powers. For that reason, it is dispositive for present purposes that the trustee may only recover property that was involved in an avoidable transfer from a "transferee." *Id.* § 550.

Thus, as the Eleventh Circuit correctly recognized, section 546(e) is not implicated if a financial institution or other protected entity is involved in a transfer only as a conduit or intermediary, because under the settled interpretation of section 550 such a conduit is not a "transferee" from which property may be recovered by the trustee. As the Eleventh Circuit and other courts of appeals have understood, a "transferee" must possess a beneficial interest in the transferred property. Petition at 13. This result flows directly from the interaction of the *Code* provisions specifying the transfers a trustee may avoid—sections 544, 545, 547, 548 and 549—and section 550, the provision governing recovery of property that is the subject of an avoidable transfer. The exception in section 546(e) then applies to those transfers reachable by the trustee, *i.e.*, transfers to transferees. The Eleventh Circuit concluded that section 546(e) was not applicable in *Munford* because the only transferees were shareholders, a class of persons who it held do not enjoy protection from the general avoidance power.

The Third Circuit, by contrast, began and ended its analysis by interpreting the language of section 546(e) in isolation, concluding that the "plain language" of that provision could be and ought to be interpreted without reference to the other pertinent provisions of the *Code* to which section 546(e) creates an exception. Pet. App. at 21a. The Third Circuit reasoned that, because section 546(e) standing alone does not specifically state that the protected

entities must be involved in the transfer as either a debtor or a transferee, any involvement by a protected entity is sufficient to invoke the exception. That approach not only ignores this Court's repeated cautions against interpreting statutes on the basis of "isolated words or sentences," *United States Nat'l Bank v. Independent Ins. Agents, Inc.*, 508 U.S. 439, 455 (1993), but also contravenes the basic rule that requires statutory exceptions to be construed narrowly in order to avoid situations in which an exception would effectively destroy the primary application of the statutory rule to which Congress has carved an exception. *Commissioner of Internal Revenue v. Clark*, 489 U.S. 726, 739 (1989); *see also A.H. Phillips, Inc. v. Walling*, 324 U.S. 490, 493 (1945). Indeed, the Third Circuit's purported "plain language" approach impermissibly produces the anomalous result that the exception in section 546(e) applies to transfers that cannot be reached by the general avoidance and recovery provisions of the *Code*.[4]

The Third Circuit's statutory analysis also conflicts with the actual text of section 546(e) itself. As respondents note,

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[4] Moreover, the terms of section 546(e) do not insulate from the trustee's avoidance power a "transaction," Opp. at 11, that "involves" a settlement payment, but rather a "transfer" that "is" a settlement payment. Thus, the "transfer" that may be excepted under section 546(e) must necessarily be an otherwise avoidable transfer under the *Code*. The record is clear that an avoidable transfer was not made "by" or "to" Chase or Merrill Lynch because neither of them is the debtor or transferee from whom recovery could have been made. The avoidable transfer at issue is between Resorts and respondents.

the Third Circuit's "plain language" approach led it to conclude that there was "no basis" to "leave former public shareholders outside of the protections of section 546(e)." Opp. at 6. Former public shareholders, of course, are not one of the protected entities delineated in the text of section 546(e). The Third Circuit's "plain language" approach, thus, has grafted a new class of new protected entities—former public shareholders—into the text of section 546(e).

2. Respondents are mistaken in their contention that the issues presented by this case "are not likely to be important in the bankruptcy context in the future" because leveraged buyouts ("LBOs") are less frequent today than they were in the 1980s. Opp. at 8. As an initial matter, that contention overlooks the fact that the question presented by petitioner is being actively litigated today; indeed, the circuit conflict at issue has arisen within the past two years. Nor do respondents acknowledge that the lower courts continue to be confronted with the precise issue presented by this case. *See* Petition at 25 (citing cases).

Moreover, contrary to respondents' assertions, it is not petitioner's position that the Third Circuit's statutory analysis is, or could be, confined solely to the LBO context. *See* Opp. at 7-10. While LBOs obviously are an important factual scenario in which this issue can arise, the Third Circuit's broad holding regarding the scope of section 546(e) is not limited to the LBO context. The practical ramifications of the Third Circuit's holding are vast. Under the Third Circuit's construction of section 546(e), any transferee of a debtor's interest in property may escape the trustee's avoidance and recovery powers simply by having the transaction run through a financial institution, a stockbroker, or another protected entity. Even respondents reason that

under the Third Circuit's view of section 546(e), anytime Merrill Lynch (and presumably any other stockbroker) is involved in the transfer of funds from a debtor, the property is exempted from the avoidance power. *See* Opp. at 13 ("if an entity is a stockholder, the Code treats all transfers of property, stock or cash to have taken place in a stockbroker-customer relationship"); *id.* at 14 (because Merrill Lynch is a stockbroker, "it follows that section 546(e) has specifically exempted [the] payments" at issue); *see also id.* at 14 n.8. Consequently, any transferee can circumvent the trustee's general avoidance and recovery power by employing a stockbroker to process the transfer of a debtor's interest in property. That is far from what Congress could have intended when it enacted section 546(e), let alone what the language of the statute would support.

3. In a final effort to distract the Court from this important question of bankruptcy law that divides the courts of appeals, respondents claim that there is a "jurisdictional flaw" underlying this case that would "likely" bar the Court from reaching the merits. Opp. at 16. Respondents are wrong. Respondents argue that the removal of this case to the Bankruptcy Court for the District of New Jersey pursuant to 28 U.S.C. § 1452 and Bankruptcy Rule 9027 was improper. *Id.* at 16-18. The Third Circuit rejected precisely the same argument out of hand in a footnote, concluding that the argument is so lacking in merit that it warranted no discussion whatsoever. Pet. App. at 22 n.12.

Respondents ask this Court to reconsider the jurisdictional argument rejected by the Third Circuit, but they do not bother to provide any principled basis to support their claims or even to describe in so many words the nature of their jurisdictional objection. Indeed, respondents do not cite

to a single decision by a court of appeals supporting their claim or suggesting that the Third Circuit erred in exercising jurisdiction.[5] All respondents say is that the "majority of cases" that purportedly have considered the propriety of removal in analogous circumstances have barred such removal. But the "majority of cases" referenced by respondents, Opp. at 17-18, amount to a handful of bankruptcy and district court decisions interpreting 28 U.S.C. § 1452.

Further, the alleged defect in the case cannot fairly be considered "jurisdictional" even on respondents' view of the facts, since even respondents acknowledge that the case could properly have been "transferred" to the District of New Jersey under a different statute. Thus, respondents necessarily must acknowledge that the Bankruptcy Court had subject matter jurisdiction over this case. *Id.* at 18 & n.12. That is fatal to their argument, because it makes clear that the alleged defect amounts at most to a miscitation that could not have affected the parties' substantial rights. That is precisely the type of error that Congress has long instructed this Court

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[5] The Court of Appeals for the Federal Circuit commented on a similar jurisdictional challenge based on an allegedly improper removal under 28 U.S.C. § 1452. *See Quality Tooling, Inc. v. United States*, 47 F.3d 1569 (Fed. Cir. 1995). That court, like the Third Circuit, rejected the challenge. The Federal Circuit held that removal of an action from the federal court of claims in Washington, D.C., to a District Court in Alabama sitting in bankruptcy was authorized under 28 U.S.C. § 1452. *Quality Tooling*, 47 F.3d at 1572.

to disregard on certiorari. 28 U.S.C. § 2111.[6] Moreover, the alleged defect in the removal was procedural, and if it is not raised in a motion to remand within thirty days, it is waived. *See Caterpillar v. Lewis*, 519 U.S. 61, 69 (1996); *Belcufine v. Aloe*, 112 F.3d 633, 638 (3d Cir. 1997). Respondents waived their objection to the removal here because they failed to oppose it within thirty days. *See Things Remembered, Inc. v. Petrarca*, 516 U.S. 124, 127, 129 (1995) (28 U.S.C. § 1452, the bankruptcy removal statute, is to be read in conjunction with 28 U.S.C. § 1447(d), regarding removal generally, which in turn must be read with 28 U.S.C. § 1447(c)). This Court plainly has jurisdiction to decide this case.[7]

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[6] At worst, respondents' complaint is that the matter should have gone first to the District Court of New Jersey, which could then refer the matter to the Bankruptcy Court under 28 U.S.C. § 157(a). Opp. at 18. The District of New Jersey has in place a standing order of referral that would have sent this case to the Bankruptcy Court in any event. *See In re SKC Corp.*, 54 B.R. 165, 168 (Bankr. D.N.J. 1984).

[7] Of course, if the Court were somehow to determine that the lower courts are divided about the application of 28 U.S.C. § 1452, and that that issue warrants resolution at this time, that would be a reason *for*, rather than *against*, review here. Respondents themselves, however, have provided a telling assessment of that purported jurisdictional defect by failing to cross-petition on that question, and there is no good reason for this Court not to let the matter rest where respondents themselves were content to have it remain.

CONCLUSION

For the foregoing reasons, and for those set forth in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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Dated: November 10, 1999

Supreme Court, U.S.
FILED
OCT 29 1999
CLERK

No. 99-552

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SUN INTERNATIONAL NORTH AMERICA, INC.,

Petitioner,

v.

LAURANCE LOWENSCHUSS, TRUSTEE OF THE FRED LOWENSCHUSS ASSOCIATES PENSION PLAN and LAURANCE LOWENSCHUSS I.R.A.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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QUESTIONS PRESENTED

Petitioner asks this Court to consider whether the United States Court of Appeals for the Third Circuit erred when it applied 11 U.S.C. § 546(e) of the Bankruptcy Code to bar petitioner's pursuit of a fraudulent transfer action against petitioner's former shareholder arising out of a leveraged buyout transaction. Section 546(e) specifically excerpts from the Code's avoidance powers settlement payments (as defined by section 741(8) of the Bankruptcy Code) made by financial institutions, stockbrokers or securities clearing agencies to their customers. A settlement payment is *any* payment, preliminary or otherwise, commonly used in a securities transaction.The Third Circuit concluded that because the shareholder and petitioner utilized the services of a stockbroker and another financial institution to surrender the shares in exchange for payment, that consideration constituted a settlement payment and section 546(e) barred the petitioner's lawsuit. The Third Circuit held that the plain language of the Bankruptcy Code encompassed the payment at issue and that neither the statute nor the legislative history suggested that Congress intended a more narrow reading of the provision. Thus, the question presented is:

Whether the Third Circuit correctly interpreted section 546(e) to bar a debtor-in-possession or trustee from bringing a constructive fraudulent transfer action to recover a payment made by a financial institution or a stockbroker to a shareholder when the payment is a straightforward settlement transaction.

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OPINIONS BELOW

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STATEMENT OF JURISDICTION

Respondents do not contest the Court's jurisdiction under 28 U.S.C. § 1254(1). Nonetheless, the respondents contend that should the Court grant the petition, the record will show that the bankruptcy court improperly exercised jurisdiction over the adversary proceeding and the respondents.

STATUTORY PROVISIONS INVOLVED

Although several provisions of the Bankruptcy Code and state law are implicated by this matter, the critical provisions include 11 U.S.C. § 546(e) of the Bankruptcy Code, which provides in relevant part:

> Notwithstanding sections 544, . . . 548(a)(2), and 548(b) of this title, the trustee may not avoid a transfer that is a . . . settlement payment, as defined in section 101 or 741 . . . , made by or to a . . . stockbroker, financial institution, or securities clearing agency. . . .

11 U.S.C. § 546(e). Another important Code provision, section 741, defines a settlement payment to mean:

> a preliminary settlement payment, a partial settlement payment, an interim settlement payments, an interim settlement payment, a settlement payment on account, a final settlement payment on account, a final settlement payment

> or an other similar payment commonly used in the securities trade.

11 U.S.C. § 741(8).

STATEMENT OF THE CASE

In November 1988, Resorts International, Inc. ("RII"), the predecessor in interest to petitioner Sun International North America, Inc., offered all of its Class A common stockholders $36 per share as part of a leveraged buyout transaction ("LBO"). At the time, RII Class A shares were publicly traded on the American Stock Exchange. The Fred Lowenschuss Associates Pension Plan ("Pension Plan"), and the individual retirement accounts ("IRAs") of Laurance and Fred Lowenschuss[1] owned approximately 105,900 Class A shares combined (the "Shares").

RII forwarded a "Notice of Merger of Griffco Acquisition Corp. With and Into Resorts" and an attached Letter of Transmittal to all shareholders. The Notice of Merger provided that shareholders would receive the Merger Price when the Letter of Transmittal and certificates were presented to RII's agent, Chase Manhattan Bank ("Chase"), on or before November 15, 1989. The Letter of Transmittal also permitted appraisal shareholders (of which the Pension Plan was one) to withdraw their appraisal demand at any time in exchange for the merger consideration. RII's forms neither contained a time limit for withdrawal of appraisal requests nor were they amended, superseded or modified. Consistent with the Letter of Transmittal, the Pension Plan decided to withdraw its appraisal demand and tender its stock.

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1. Fred Lowenschuss and the 100 Shares in his IRA were severed from the case before trial, and he was not a party. Laurance Lowenschuss, as the representative of the Pension Plan and his IRA, is the respondent. For simplicity sake, the Pension Plan and the Laurance Lowenschuss IRA are collectively referred to as the Pension Plan.

The critical facts that bear on the petition relate to the Pension Plan Trustee's exchange of stock for payment in a typical settlement transaction. On July 17, 1989, the Pension Plan Trustee delivered the Shares to its stockbroker, Merrill Lynch, in accordance with RII's proxy materials. Merrill Lynch then forwarded the Shares through the normal brokerage process to Chase, which RII designated as its paying and transfer agent for the Shares. Chase took possession of the Shares. On July 27, 1989, Chase mailed Transfer Journal Sheets dated "07/26/89" to RII identifying the Pension Plan as having surrendered 105,700 shares. Therefore, both RII and Chase (RII's agent) knew that the Shares had been presented for payment.

As with every other surrender share of Class A stock, RII permitted its paying and transfer agent to settle the transaction. On August 1, 1989, RII wired $3,812,313.60 to Chase to pay, *inter alia*, for the Shares. Chase sent a $3,805,200 check payable to Merrill Lynch for the Shares. After receiving the payment, Merrill Lynch, in turn, paid the Pension Plan in full settlement of the surrendered Shares. RII similarly paid *every* tendering shareholder through November 3, 1989.

After the fact, RII determined, for various reasons, that it wanted its money back. RII filed a Complaint on September 26, 1989, in the United States District Court for the Eastern District of Pennsylvania ("Pennsylvania Court") naming Fred Lowenschuss individually and as Trustee of the two IRA's (but not as the Pension Plan Trustee). The record owner of the Shares, the Pension Plan, was not named or referenced in the Complaint. The Complaint sought to reverse the exchange of the Shares, for which RII paid $3.8 million. Fred Lowenschuss filed an Answer and Counterclaims.

After the filing of an involuntary bankruptcy petition on November 12, 1989 against RII in the United States Bankruptcy Court for the District of New Jersey, RII and

several affiliates either consented to or filed for chapter 11 relief.[2] This matter became an adversary proceeding before the bankruptcy court when RII "removed" it *directly* from the Pennsylvania Court, allegedly pursuant to 28 U.S.C. § 1452(a).

Although the case was filed in 1989, it took many years for it to proceed on the merits. RII's primary — and unique — argument was that its *own* proxy materials and conduct were an illegal contract, constituted a mistake or were the result of the Pension Plan Trustee's fraud. It was only after the removal of the action that RII filed an amended complaint that asserted constructive fraudulent transfer claims under N.J.S.A. 25:2-25(b) and 25:2-27(a) and under 11 U.S.C. § 548(a)(1)(B).[3] Thus, while arising in bankruptcy due to RII's chapter 11 filing, the matter primarily was a dispute involving simple, common law claims with the fraudulent transfer claims appended almost as an afterthought. On motions for partial summary judgment in February 1992, the bankruptcy court found the transfer to have been contrary to Delaware appraisal law but left the remedy and remaining mistake, fraud and fraudulent transfer counts for trial.

Having initially omitted the record owner of the Shares, RII moved to have the Pension Plan deemed a party, and by a June 13, 1995 Order, the Pension Plan was declared to have been a party from the case's inception in disregard of

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2. The Bankruptcy Court ultimately confirmed RII's Plan of Reorganization in 1990. *In re Resorts International, Inc.*, 145 B.R. 412 (Bankr. D.N.J. 1990). RII subsequently filed a second bankruptcy in the United States Bankruptcy Court for the District of Delaware in 1994. RII confirmed a second Plan of Reorganization that same year.

3. RII also asserted an actual fraudulent transfer claim under state and bankruptcy law. However, recognizing that it could not meet the requisite elements of this claim, RII abandoned it after trial.

prior contrary findings.[4] The bankruptcy court then severed the claims against Fred Lowenschuss individually from those against the Pension Plan and Laurance Lowenschuss's IRA and proceeded solely against the Pension Plan and IRA. At trial in November 1995, RII sought rescission and restitution on the grounds of mistake, fraud and illegal contract and to avoid the payment as a fraudulent transfer.

On April 22, 1997, the court issued an opinion, finding for RII as to mistake, fraud and illegal contract, dismissing the fraudulent transfer claims as barred by operation of section 546(e) of the Bankruptcy Code, and awarding $3,805,200, plus punitive damages of $250,000 and prejudgment interest against the Pension Plan. A judgment was entered on May 20, 1997. The court thereafter eliminated joint liability, limiting the judgment against the IRA to $3,600, plus punitive damages of $237 and interest of $1,561.84, and the Pension Plan to $3,801,600, plus punitive damages of $249,763 and interest of $1,649,373.53.

In an unreported opinion, the United States District Court for the District of New Jersey reversed the judgment on the mistake, fraud and illegal contract claims. Pet. App. 45a-46a. The district judge held that RII failed to prove even the most basic elements of the common law. Pet. App. 29a-43a n.7. The district court affirmed without substantial discussion of the bankruptcy court's dismissal of the fraudulent transfer claims.

The Third Circuit agreed with the district court that RII's common law claims had no merit. Pet. App. 6a-15a. The critical ruling for purposes of RII's petition was the circuit court's holding that section 546(e) of the Bankruptcy Code barred RII constructive fraudulent transfer claims against the

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4. The improper exercise of jurisdiction over the Pension Plan is also grounds for dismissal of the underlying adversary proceeding with respect to the Pension Plan.

Pension Plan. In particular, the Third Circuit found that the Pension Plan's use of Merrill Lynch as its stockbroker and RII's use of Chase to exchange the Shares for the settlement payment barred any suit against the Pension Plan. Pet. App. 22a. The panel found that RII's payment was a settlement payment as defined by the Code, given the broad language used by Congress in defining "settlement payment." Pet. App. 18a. The circuit court found *no* basis to limit the definition of "settlement payment" so as to exclude an LBO transaction.[5] Pet. App. 20a. The court also refused to ignore the statute as written by Congress: to bar all attempts to avoid payments by a stockbroker or financial institution to a shareholder using constructive fraudulent transfer causes of action. Pet. App. 20a-21a. The court concluded that there was no basis to ignore the plain language of the statute that would leave former public shareholders outside of the protections of section 546(e). Pet. App. 21a.

REASONS FOR DENYING THE WRIT

THE FRAUDULENT TRANSFER LAWS WERE NEVER APPLICABLE TO THE TRANSACTION BETWEEN RII AND THE PENSION PLAN

This Court may issue a Writ of Certiorari to consider matters where the petitioner has demonstrated that two or more circuit court rulings are in conflict over a question of national importance. Sup. Ct. R. 10(a). RII's petition suggests that a circuit conflict exists. However, the alleged conflict, if one exists at all, is simply not of the importance or nature to warrant review by this Court. Even if the Court were to

5. Indeed, no court has ever pointed to a specific passage of legislative history that shows Congress intended to *exclude* LBO transactions from the term "settlement payment". RII also fails to identify any specific legislative history that supports such an interpretation; rather it simply states that at the time section 546(e) was enacted, no one "suggested" that an LBO was the type of transaction that should come within the statute's reach.

ultimately consider the question, it is unclear whether it would reach the merits, as there are serious jurisdictional flaws in RII's underlying case discussed more fully in section C, *infra*. Moreover, given that there is no real conflict and that the Third Circuit's ruling is the correct decision, there is no need for review on the merits at this time. The question raised by RII is simply not one of great importance to the future interpretation of the Bankruptcy Code, and the Court should decline to issue a Writ of Certiorari.

A. While Section 546(e) May Be An Important Statute, The Issue For Which RII Seeks Review Is Not One Of National Importance.

It is not disputed that because of the sometimes conflicting goals of the federal securities laws and the Bankruptcy Code, Congress chose to exempt certain securities transactions from the trustee avoidance powers of the Bankruptcy Code. Indeed, in section 546(e) of the Code, Congress decided to exempt any payment made by or to a stockbroker or other financial institution in exchange for the tender of securities from the application of constructive fraudulent transfer law.

RII's petition focuses on whether a particular type of transaction, a leveraged buyout, qualifies as a securities transaction within the meaning of section 546(e). RII argues that the Third Circuit was mistaken in applying section 546(e) to an LBO for two reasons. First, RII asserts that because of the nature of an LBO transaction, the brokerage and financial institutions in the settlement chain are not "transferees" but mere conduits, thereby permitting the courts to ignore such entities' presence in the transaction. Second, RII argues that LBO payments received by a shareholder from an entity in the securities clearance chain are not "settlement payments" as defined by the Bankruptcy Code. In seeking the writ, RII argues that answering these questions is an issue of critical national importance. This is simply not the case.

What RII seeks is to have this Court consider is an issue that has its roots in a financial practice that was a product of the 1980s' merge and acquisition mania. While still occurring today, LBOs are less frequent and take a substantially different form from the 1980s version. As a result, the issues are not likely to be important in the bankruptcy context in the future.

By definition, a leveraged buyout involves the takeover of a company using borrowed funds. *See* DICTIONARY OF FIN. & INV. TERMS 297-98 (John Downes & Jordan Elliot Goodman eds., 4th Ed. 1995). Often, the target company's assets serve as the collateral for the loans used to finance the purchase. *Id.* The acquiring company then repays the loans from the target entity's profits or by selling the target's assets. *Id.* During the 1980s, many leveraged buyouts were financed through the issuance of "junk bonds". *Id.* at 284. Junk bonds are corporate debt instruments that involve greater than usual risk as an investment and pay a relatively high rate of interest. *Id.* Such bonds are typically issued by a company lacking an established earnings history or having a questionable credit history. *Id.*

In the past, when companies were acquired through LBOs, the target's debt burden was often too large for the target to handle. This fact resulted in a rash of corporate bankruptcies in the late 1980s and early 1990s, as well as portfolios of valueless junk bonds. *See* John Greenwald, *LBOs: Let's Bail Out if the Economy Goes South, Debt-Heavy Buyouts Could Go Under*, Time, Aug. 14, 1989, at 50. Many otherwise financial sound companies were the victims of LBO mania. *See, e.g., id.* RII was one target company that could not meet its debt burden and which ultimately was forced to seek chapter 11 protection twice.

It is estimated that during the 1980s, at least $500 billion in LBO transactions took place. During the 1990s, companies transacted just a fraction of the number and amount of LBOs,

while at the same time, total equity market capitalization has soared to unprecedented levels.[6] The financing of LBOs has also changed radically since 1990. The overwhelming majority of recent LBOs were financed in a manner other than through the junk bond market. *See* Merrill Goozner, *Investors Flocking to Junk Bonds, But Risks Are Not for Everyone*, Dallas Morn. News, June 15, 1997. Thus, post-LBO companies of today appear financially more sound than their 1980's counterpart.

Of particular interest is the fact that the impact of the leveraged buyout to the bankruptcy process has all-but-disappeared. Even the most recent circuit cases, the one

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6. Considering the relative value of publicly traded companies in 1980s as opposed to the 1990s further reinforces the loss of importance of LBOs in today's business world. In 1990, total market capitalization of all publicly traded companies on the New York Stock Exchange was estimated to be $2.6 trillion. William E. Sheeline and Alan Deutschman, *Money & Markets: Who Needs The Stock Exchange? We All Do, Because It Is The Central Marketplace That Sets The Prices For Investors. But America's No. 1 Exchange Is Threatened With Unplanned Obsolescene*, Fortune, Aug. 19, 1990. $500 billion in LBO transactions during the 1980's constituted a not insubstantial percentage of market capitalization. Since 1990, the total market capitalization of the New York Stock Exchange has more than quadrupled, exceeding $11.3 trillion, while total market capitalization of all United States exchanges exceeds $28 trillion. *Hearings on Proposals Certified to Save Social Security Before the House Committee on Ways and Means*, 106th Cong., 1st Sess. (1999) (statement of the Honorable Marshall "Mark" Sanford, M.C., South Carolina) (available on the internet at www.house.gov/ways_means/hearin.htm). By comparison, from 1996 to 1998, the three most-active LBO years since 1989, only about $84 billion in LBO transactions took place. *See Buyout Deals Reach $41 Billion*, UPI, Jan. 1, 1999; Matthew Schifrin, *LBO Madness*, Forbes, Mar. 9, 1998, p. 128; Tom Petruno, *Buyouts Are Back. LBOs, One Symbol of Greed in '80s, Are Giving Stock Market a Boost*, Minneapolis Star Tribune, Dec. 12, 1996, p. 01D. As a percentage of market capitalization, LBOs are simply not significant.

before this Court now and *Munford v. Valuation Research Corp. (In re Munford, Inc.)*, 98 F.3d 604 (11th Cir. 1996), *cert. denied, sub nom. Dimensions Group, Inc. v. Munford, Inc.*, __ U.S. __, 118 S. Ct. 739, *and Munford v. Munford, Inc.*, __ U.S. __, 118 S. Ct. 739 (1998), were the result of LBO transactions that occurred nearly ten years ago. None of the lower court cases cited in RII's petition appears to involve an LBO that took place more recently than 1991. And, given today's business climate, the unwinding of LBO transactions is not likely to be an important feature of future bankruptcy cases.

After the failure of many LBOs, it is not surprising that creditors, trustees and debtors-in-possessions turned to the fraudulent transfer laws to attempt to recover some of their losses. In cases that did not involve the securities process, section 546(e) was no bar to recovery under a fraudulent transfer theory. However, when lawsuits started to include shareholders of publicly traded companies, section 546(e) of the Bankruptcy Code on its face seemed to bar fraudulent transfer actions. *See, e.g., Kaiser Steel Corp. v. Pearl Brewing Co. (In re Kaiser Steel Corp.)*, 952 F.2d 1230, 1240 (10th Cir. 1991). Several courts have attempted to circumvent 546(e), ostensibly relying upon what Congress allegedly intended when enacting section 546(e). As discussed *infra*, the rationale put forth by these courts was unnecessary as the facts surrounding the transactions clearly put them outside of the scope of the securities clearance system. Thus, it is difficult to image how such a ruling by the Court in this proceeding will provide more guidance than the Third Circuit has already provided.

B. The Record Below Will Not Support A Ruling That Will Resolve The Alleged Conflict Between The Circuits.

The Third Circuit concluded that the Pension Plan's utilization of Merrill Lynch as its stockbroker and RII's use

of Chase as its paying and transfer agent insulated the LBO transaction from the reach of the avoidance powers. Pet. App. 22a. In reaching that determination, the panel noted that it was not in agreement with the reasoning of the majority in the Eleventh Circuit case in *In re Munford*, at least as to whether the transfer was made to or by a protected entity. Pet. App. 21. The Third Circuit also noted that it did not agree with several district court cases which had ruled that receiving consideration in exchange for delivery of shares in an LBO was not a "settlement payment" as defined by the Bankruptcy Code. Pet. App. 19a. However, regardless of the Third Circuit's disagreement with the reasoning of those cases, there is neither a true circuit conflict nor a meaningful conflict with any of the district court rulings.

It is important to note a critical factual distinction between the transaction in *Munford* and the one in this case. In *Munford*, the debtor's shareholders delivered their shares directly to a bank that held the debtor's funds in trust to pay for the shares. 98 F.3d at 610. According to the circuit panel, the bank did not obtain a "beneficial interest in the funds" as it was not serving as an entity in the securities clearance chain.[7] *Id.* Consequently, the Eleventh Circuit held that the bank was merely a conduit for the transfer of the funds to the former shareholders. *Id.* The *Munford* Court effectively collapsed the transaction so that it involved a transfer of stock directly to the target corporation in exchange for payments directly to the shareholders.

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7. The district court found that the bank was holding the funds deposited by the debtor as trust funds and was effectively nothing more than an escrow agent. *See Munford, Inc. v. Munford*, 188 B.R. 860, 863 (N.D. Ga. 1996), *aff'd in part, rev'd in part sub nom. Munford v. Valuation Research Corp. (In re Munford, Inc.)*, 98 F.3d 604 (11th Cir. 1996), *cert. denied, sub nom. Dimensions Group, Inc. v. Munford, Inc.*, __ U.S. __, 118 S. Ct. 739, *and Munford v. Munford, Inc.*, __ U.S. __, 118 S. Ct. 739 (1998). There is no such finding in this case.

In this case, Chase did not hold the payment as a trust fund or merely serve as an escrow agent. Rather, RII admitted Chase served as both its paying and transfer agent. The common understanding is that paying agents are responsible for paying dividends or making other distributions on behalf of the corporation to shareholders. DICTIONARY OF FIN & INV. TERMS at 410. Transfer agents are responsible for maintaining shareholder records and canceling and issuing shares on behalf of the corporation. *Id.* at 615. Thus, it appears that Chase was operating in the context of the securities settlement process when it accepted delivery of the Shares and forwarded the funds to Merrill Lynch that ultimately were used to pay the Pension Plan.

Second, there was an additional entity in this transaction that was not present in *Munford*. The Pension Plan employed Merrill Lynch, its stockbroker, to effectuate the transaction. A " 'stockbroker' means [a] person . . . with respect to which there is a customer, as defined in section 741(2) of this title. . . ." 11 U.S.C. § 101(53A)(A). A "customer" is defined, in relevant part, as

> (A) entity with whom a person deals as principal or agent and that has a claim against such person on account of a security received, acquired, or held by such person in the ordinary course of such person's business as a stockbroker, from or for the securities account or accounts of such entity — . . .
>
> (ii) with a view to sale; . . .
>
> (B) entity that has a claim against a person arising out of —
>
> (i) a sale or conversion of a security received, acquired, or held as specified in subparagraph (A) of this paragraph; or

> (ii) a deposit of cash, a security, or other property with such person for the purpose of purchasing or selling a security;

11 U.S.C. § 741(2). According to the Sixth Circuit, "the legislative history [of section 741(2)] suggests that a customer includes 'anybody that interacts with the [alleged stockbroker] in a capacity that concerns security transactions.' " *WesBanco Bank Barnesville v. Rafoth (In re Baker & Getty Fin. Svcs., Inc.)*, 106 F.3d 1255, 1260 (6th Cir.), *cert. denied*, 118 S. Ct. 65, 139 L. Ed. 2d 27 (1997), *quoting* H.R. Rep. No. 95-595 (1977), *reprinted in* 1978 U.S. Code & Cong. Ann. News. 6223-27. The Sixth Circuit also noted that

> the definition of customer turns on the *purpose of the* [investor] rather than the status or intent of the [stockbroker]. An investor qualifies as a customer when the investor *deposits money or securities* with the [stockbroker] with the expectation that the [stockbroker] purchase stock or trade securities.

Id. (emphasis supplied). The *WesBanco* panel also rejected the contention that because the entity may have not been executing a securities trade on behalf of the customer in a particular circumstance, the entity lost its status as a stockbroker for that particular transaction. *See id.* at 1262 (unlicensed broker that converted customer deposit for its own purposes rather than to conduct a trade remained a stockbroker as it had engaged in trades on behalf of other customers in the past). Therefore, if an entity is a stockholder, the Code treats all transfers of property, stock or cash to have taken place in a stockbroker-customer relationship.

The Pension Plan was a "customer" within the meaning of the Bankruptcy Code. It delivered securities or "property"

to Merrill Lynch in the anticipation that Merrill Lynch would complete the stock purchase transaction. Since it cannot seriously be disputed that Merrill Lynch was a stockbroker at the time of the transaction as defined by the Bankruptcy Code,[8] it follows that section 546(e) has specifically exempted payments *by or to* Merrill Lynch from the reach of the avoidance powers. This relationship did not exist in *Munford*, strongly suggesting that the reasoning of *Munford* is inapplicable here.[9]

While RII acknowledges that there is no circuit-level conflict as to the definition of "settlement payment," it seeks to elevate supposed conflicts at the district court level to ones of substantial importance. However, as with the *Munford* case, the record relied upon by the Third Circuit to determine that the payment here constituted a settlement payment

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8. Even if the Pension Plan were not a customer, Merrill Lynch has hundreds of thousands of customers who utilize Merrill Lynch as a stockbroker. Thus, for purposes of section 546(e), Merrill Lynch qualifies as a stockbroker. *See WesBanco*, 106 F.3d at 1262.

9. RII attempts to elevate two circuit decisions addressing the "mere conduit" theory under 11 U.S.C. § 550, *Christy v. Alexander & Alexander of New York Inc. (In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey)*, 130 F.3d 52, 59 (2d Cir. 1997), and *Bonded Fin. Svcs. v. European Am. Bank*, 838 F.2d 890, 893 (7th Cir. 1988), as cases in conflict with the Third Circuit's decision here. Neither case had anything to with the application of section 546(e) or LBO transactions. More importantly, the more specific Code section, section 546(e), operates without reference to the requirements of the more general section 550. Section 546(e) simply exempts from the reach of the trustee or debtor any person receiving payments from one of the specified entities. There is no requirement that the specified entity also be considered a transferee for purposes of fraudulent transfer law. Rules of statutory construction therefore run counter to RII's argument. *Simpson v. United States*, 435 U.S. 6, 7 (1978) ("precedence should be given to the terms of the more specific statute where a general statute and a specific statute speak to the same concern . . .").

differs sharply from the facts in the lower court cases cited by RII. This factual difference naturally limits the importance of a ruling on the merits.

For example, in *Zahn v. Yucaipa Cap. Fund*, 218 B.R. 656, 676 (D.R.I. 1998), there was simply *no* exchange of stock for cash through any of the entities listed in section 546(e). In fact, the stock in *Zahn* was even not publicly traded, and, thus did not implicate the securities settlement system in any way.[10] *Id.* Similarly, in *Jewel Recovery, L.P. v. Gordon*, 196 B.R. 348, 353-54 (N.D. Tex. 1996), *Brandt v. Hicks, Muse & Co., Inc. (In re Healthco Internat'l, Inc.)*, 195 B.R. 971, 981 (Bankr. D. Mass. 1996) and *KSC Recovery, Inc. v. First Boston Corp. (In re Kaiser Merger Litigation)*, 168 B.R. 991, (D. Colo. 1994), each court held section 546(e) to be inapplicable because the shareholders were not paid by any one of the listed entities in section 546(e), and in the case of *KCS Recovery*, the alleged payments were found to have predated the LBO and to have been made in return for proxies and options for new shares. Factually, each case differs radically from this case below and, by definition, fall outside the scope of section 546(e).

In *Wieboldt Stores, Inc. v. Schottenstein*, 131 B.R. 655 (N.D. Ill. 1991), a district court held that payments of LBO consideration were not settlement payments. The case is again distinguishable because of important factual differences. First, as in *Munford*, the financial institution in question did not appear to be functioning as anything more than an escrow agent for the acquired entity; thus, the entity's role and the roles of Chase and Merrill Lynch here differed

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10. RII suggests in footnote 15 of the petition that the *Zahn* Court's refusal to apply section 546(e) to an alleged private stock sale intermediary that was not specifically named in the statute was the elevation of substance over form. Respondent respectfully suggests that a more plausible basis for the *Zahn* Court's decision is that was merely applying the statute as written.

substantially. Second, the district court ruled that although the legislative history was not dispositive and the statute appeared facially applicable, it was free to ignore the statute's language because in that particular transaction, the court was unable to perceive of any risk to the clearance and settlement chain. *Id.* at 665-66. Thus, the *Wieboldt* case is a classic example of legislation by judicial fiat. In fact, all the circuits considering section 546(e) have rejected or sharply criticized the reasoning of *Wieboldt*, one noting that:

> On its face, the statute is clear. The statue exempts payments made "by or to" a stockbroker, financial institution, or clearing agency. Again, unless there is some reason to believe the clear application is abused and otherwise unreasonable we leave our inquiry at that.

In re Kaiser Steel, 952 F.2d at 1240 (emphasis supplied). *See In re Munford, Inc.*, 98 F.3d at 610 n.4 ("We reject the reasoning of *Wieboldt[,]* finding that even granting trustees avoidance powers under limited circumstances in the LBO context has the potential to lessen confidence in the commodity market as a whole.").

C. The Trial Court Lacked Jurisdiction Because Of The Improper Removal From The Pennsylvania Court.

There is a serious jurisdictional flaw that would likely prevent the Court from reaching the merits upon the granting of a writ.[11] After the initiation of RII's bankruptcy, RII removed this case directly from the Pennsylvania Court under 28 U.S.C. § 1452 to the bankruptcy court. In upholding the "direct removal," the lower courts rejected case law that held

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11. In addition, respondents believe that the bankruptcy court's order that permitted RII to "amend the caption" to add the Pension Plan Trustee as a party was also error. Reversal of that order would also deprive the bankruptcy court of jurisdiction.

that a direct removal is in contravention of the removal statute and 28 U.S.C. § 157(a).

The majority of cases that have addressed "direct removal" have rejected it and found it to be a void act. *See Cornell & Co., Inc. v. Southeastern Pa. Transp. Auth. (In re Cornell & Co., Inc.)*, 203 B.R. 585 (Bankr. E.D. Pa. 1997); *Thomas Steel Corp. v. Bethlehem Rebar Indus., Inc.*, 101 B.R. 16 (Bankr. N.D. Ill. 1989). While some decisions like *Cornell* involved a transfer between courts in the same district, other cases make it clear that section 1452 does not allow a transfer from *any* court directly to the bankruptcy court. *Furr v. Barnett Bank of Marion Cty. (In re S & K Air Power of Fla., Inc.)*, 166 B.R. 193 (Bankr. S.D. Fla. 1994); *Centrust Sav. Bank v. Love*, 131 B.R. 64, 66-67 (S.D. Tex. 1991). *But see In re Princess Louise Corp.*, 77 B.R. 766 (Bankr. C.D. Cal. 1987) (allowing direct removal to a bankruptcy court).

In *Centrust*, the court identified the jurisdictional flaw in direct removal, noting that in enacting section 1452, Congress expressly limited removal to "the district court." *Id.* at 66. The court then emphasized that:

> [B]ankruptcy courts receive cases by referral, never by removal. Like other case management orders, the referral is left to the discretion of the district court. . . . Proper procedure to have the case reach the bankruptcy court is to petition the district court for an order of reference.

Id. The court also stressed that "[s]ection 1452 is part of *Chapter 89: Removal of Cases from State Courts*. By its terms, it does not provide for removal from federal district court." *Id.* at 67.

Although Third Circuit summarily dismissed the jurisdictional argument (Pet. App. 22a n.12), the majority of

cases hold that any transfer between a federal district court to a bankruptcy court in another district must occur at the district court level. The proper step would then be to refer the matter under section 157(a), the only permissible basis for a bankruptcy court to exercise jurisdiction.[12] Because improper removal results in a void act, should this Court grant the writ, it would likely dismiss the case as having been improperly removed by RII.

D. Even If The Court Were To Grant The Petition, The Third Circuit's Decision Is The Proper One And Would Be Affirmed.

Section 546 expressly limits a debtor's right to pursue fraudulent transfers, preferences or other avoidance actions that involve "settlement payments" by or to a stockbroker or other institution. 11 U.S.C. § 546(e). Section 741 defines a settlement payment as broadly as possible and specifically notes that it any "other similar payment commonly used in the securities trade." 11 U.S.C. § 741(8). *See also* 11 U.S.C. § 101(51A) (similar definition as to forward contracts).

This Court has consistently admonished lower courts to literally apply federal statutes, except in those rare cases where the language will produce an absurd result or one that is clearly at odds with Congress's intent in drafting the statute. *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989). One of the basic premises put forth by this Court is that where Congress attaches no qualifiers or modifiers to a phrase, courts should not place limitations on the statute's scope. *See Lewis v. United States*, 455 U.S. 55, 60 (1980). Thus, the addition by judicial fiat of language to an unambiguous statute cannot be considered a natural reading of the statute.

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12. Notably, RII did not repeat its error when seeking to transfer a later proceeding between districts and *then* moving to have it referred pursuant to 28 U.S.C. § 157. *Laurance Lowenschuss v. Resorts International, Inc.*, 194 B.R. 339, 343, 350 (D.N.J. 1996).

The Third Circuit has commented extensively on the application of section 546(e), first, in *Bevill, Bresler & Schulmar Asset Mgmt. Corp. v. Spencer Sav. & Loan Ass'n*, 878 F.2d 742, 747 (3d Cir. 1989), and now in this case. Although the *Bevill* case involved section 546(f) in a "repo" transaction, the panel's ruling relied on the legislative history of section 546(e), upon which subsection (f) was modeled. In examining section 546(e), the *Bevill* Court concluded that the important policies behind the avoidance powers were "on a collision course" with the important policies of the securities laws. *Id.* at 751. According to the *Bevill* Court, Congress decided to remedy the conflict by:

> remov[ing] the right . . . to avoid transactions under certain circumstances. Thus, . . . the 1982 amendments were designed in cases of securities in general to "ensure that the avoiding powers of a trustee are not construed to permit margin or settlement payments to be set aside except in cases of fraud [by the purchaser]."

Id. at 751, *quoting* H. Rep. No. 97-420, 97th Cong., 2nd Sess. 1 (1982), U.S. Code Cong. & Admin. News 1982, p. 583. In addition to Congress's stated intent to protect the commodities and securities market by preventing the insolvency of a securities firm from spreading to other firms, the Third Circuit noted an additional and more expansive legislative intent in enacting section 546(e), emphasizing that:

> Congress wanted to go further to protect margin payments and settlement payments made by and to *participants* in the securities market *generally*. Accordingly, it add a new subsection to . . . § 546. . . .

Id. at 747 (emphasis supplied). Thus, the Third Circuit concluded that the exemption of settlement payments from

avoidance actions contained in section 546(e) was "extremely broad." *Id.* at 751.

Exhibiting consistency, the Third Circuit maintained its broad and literal interpretation of section 546(e) in this case, stating that,

> [i]n the securities industry, a settlement payment is generally the transfer of cash or securities made to complete a securities transaction. . . . Here, the securities passed from Lowenschuss's broker, Merrill Lynch, to the transfer bank, Chase Manhattan. Resorts wired funds to Chase which Chase then forwarded them to Merrill Lynch who paid Lowenschuss. Although no clearing agency was involved in this transfer, two financial institutions — Merrill Lynch and Chase — were. Under a literal reading of section 546, therefore, this was a settlement payment "made by . . . a financial institution."

Pet. App. 19a (internal citations omitted). According to the Third Circuit, the broad interpretation compels a conclusion that all securities transactions are to be included in the definition of settlement payments. Neither the *Bevill* panel nor the panel below noted any contrary intent expressed in the legislative history.

The Tenth Circuit has also broadly interpreted section 546(e) to include LBO consideration as settlement payments. *Kaiser Steel Corp. v. Pearl Brewing Co.*, 952 F.2d 1230, 1239-40 (10th Cir. 1991), *cert. denied*, 505 U.S. 1213 (1992). Thus, a beneficial shareholder that received a payment from its broker in exchange for shares is protected from section 544 and 548(1)(B) actions. *Id.* at 1240-41. Indeed, the transaction in *Kaiser Steel* is almost identical to the transaction in this case. In *Kaiser Steel*, the LBO agreement provided that Kaiser would be purchased for $162 million

by outside investors through a merger with a new entity owned entirely by the investors. *Id.* at 1235. Upon the merger, all common stock shareholders received the right to a $22 per share payment and shares of preferred stock, which the Tenth Circuit identified as the "LBO consideration." *Id.* After the merger, shareholders tendered shares to Kaiser's disbursing agent through brokers and intermediaries in return for the LBO consideration. *Id.* at 1235-36.

After Kaiser Steel filed Chapter 11, a trustee sought to avoid the payments, arguing that section 546(e) did not apply to LBO's. *Id.* at 1238-39. The court refused to narrow the scope of section 546 and rejected the argument:

> The former . . . shareholders effectively sold their interests to new investors for money and a continuing stake in the new entity as preferred shareholders. In settlement, the . . . shareholders tendered their shares and received payment. These payments were "settlement payments. . . ."
>
> [Such] investors[s] will not be forced to disgorge the payments several years later.

Id. at 1239-40. The court also rejected the argument that payments by brokers to equity securities holders were not covered. The court held that the "clear application" includes "settlement payments *by* or to" a stockbroker in any context and would, therefore, include payments by a broker to a shareholder. *Id.* at 1240 (emphasis supplied). There is no question that the merger consideration was a settlement payment first made by Chase, a protected entity, to Merrill Lynch, a protected entity, and then to the Pension Plan by Merrill Lynch.[13]

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13. RII would not be successful even if this Court were to consider the merits. The record evidence uniformly points to a per share value of at least $36 on the merger date and also demonstrates (Cont'd)

Courts that graft additional requirements onto the statute are not following the plain language rule. As noted by the Third Circuit, the Bankruptcy Code does not require that a settlement payment be one that involves a transfer of the beneficial interest in a stock. Pet. App. 21a. Courts that impose such a requirement are therefore acting in contravention of the plain language of the statute. Similarly, RII's argument that the *Munford* case compels one to consider first whether an entity satisfies the definition of "transferee" under 11 U.S.C. § 550 before applying section 546(e), is contrary to the express language of the Code and the rules of statutory construction, that is, the more specific statute takes precedence over the more general. *Simpson v. United States*, 435 U.S. 6, 7 (1978). There is no requirement that the listed entity in section 546(e) must be a transferee for purposes of fraudulent transfer law.

RII's suggestion that the Third and Tenth Circuits ignored the legislative intent of section 546(e) is similarly insupportable. In fact, at least one district court has admitted that the legislative history is in no way dispositive. *Wieboldt Stores*, 131 B.R. at 665. Based upon its review of the legislative history of section 546 in *Bevill*, the Third Circuit determined that Congress intended to protect *all* participants in the securities markets generally from being forced to disgorge funds in bankruptcy cases. No one, including RII, has pointed to specific legislative history that warrants a determination to the contrary. At best, RII can only suggest that such an intent was not contemplated. However, if Congress had intended to limit the bar of section 546(e), it certainly knew how. For example, Congress could have simply modified the language of the statute to make it

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(Cont'd)
that the Pension Plan waived its rights of appraisal in exchange for the merger consideration. Both facts would constitute an exchange of reasonably equivalent value, which defeats RII's fraudulent transfer argument.

inapplicable to payments to shareholders, as it did when it permitted trustee's and debtors-in-possession to pursue settlement payments that constitute actual fraudulent transfers.

CONCLUSION

A Writ of Certiorari should not be granted because the issue is not one of national legal import. The decline in popularity and the financial evolution of the leveraged buyout suggest that it will not have a meaningful impact in the bankruptcy context in the coming years. Moreover, the ruling by the Third Circuit is factually unique and therefore a decision on the merits is not likely to resolve the alleged conflicts. There is also a serious jurisdictional question that would likely prevent the Court from considering the merits in any event. Finally, the Third Circuit's ruling is simply the correct decision, and there is no need for review at this time. In sum, the petition does not raise an issue of great importance to the future interpretation of the Bankruptcy Code. Accordingly, this Court should decline to issue a Writ of Certiorari.

Respectfully submitted,

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